. . . Effective June 1, 1989

Boise, ID—Boise Air Terminal (Gowen Field), VOR/DME or TACAN RWY 28L, Amdt. 1
Boise, ID—Boise Air Terminal (Gowen Field), LOC/DME BC RWY 28L, Amdt. 5
Muscatine, IA—Muscatine Muni, VOR RWY 5, Amdt. 4, CANCELLED
Muscatine, IA—Muscatine Muni, VOR RWY 23, Amdt. 5
Muscatine, IA—Muscatine Muni, VOR RWY 30, Amdt. 4, CANCELLED
Muscatine, IA—Muscatine Muni, VOR/DME RWY 12, Amdt. 4, CANCELLED
Muscatine, IA—Muscatine Muni, NDB RWY 5, Amdt. 11
Muscatine, IA—Muscatine Muni, RNAV RWY 23, Orig.

. . . Effective May 4, 1989

Colusa, CA—Colusa County, VOR–A, Amdt. 4
Santa Rosa, CA—Sonoma County, VOR/DME RWY 14, Amdt. 1
Atlanta, GA—The William B. Hartsfield Atlanta Intl, RADAR–1, Amdt. 31
Calhoun, GA—Tom B. David Fld, LOC RWY 35, Amdt. 1
Calhoun, GA—Tom B. David Fld, NDB RWY 35, Amdt. 1
DeKalb, IL—DeKalb Taylor Muni, VOR/DME RWY 27, Amdt. 3
DeKalb, IL—DeKalb Taylor Muni, NDB RWY 27, Amdt. 1
Marion, IN—Marion Muni, VOR RWY 4, Amdt. 11
Marion, IN—Marion Muni, VOR RWY 15, Amdt. 8
Marion, IN—Marion Muni, VOR RWY 22, Amdt. 14
Marion, IN—Marion Muni, ILS RWY 4, Amdt. 5
Cherokee, IA—Cherokee Muni, NDB RWY 36, Amdt. 3
New Bedford, MA—New Bedford Muni, LOC (BC) RWY 23, Amdt. 6
New Bedford, MA—New Bedford Muni, NDB RWY 5, Amdt. 10
New Bedford, MA—New Bedford Muni, ILS RWY 5, Amdt. 23
Romeo, MI—Romeo, VOR/DME–A, Amdt. 5
Columbus, OH—Port Columbus Intl, NDB RWY 10L, Amdt. 6
Columbus, OH—Port Columbus Intl, NDB RWY 10R, Amdt. 6
Columbus, OH—Port Columbus Intl, ILS RWY 10L, Amdt. 14
Columbus, OH—Port Columbus Intl, ILS RWY 10R, Amdt. 5
Georgetown, SC—Georgetown County, NDB RWY 05, Amdt. 4
Arlington, TN—Arlington Muni, NDB RWY 15, Amdt. 6
Arlington, TN—Arlington Muni, NDB RWY 33, Amdt. 6
Jacksboro, TN—Campbell County, NDB RWY 23, Amdt. 3
Jacksboro, TN—Campbell County, RNAV–A, Amdt. 3
Waukesha, WI—Waukesha County, VOR–A, Amdt. 14
Waukesha, WI—Waukesha County, LOC RWY 10, Amdt. 3
Waukesha, WI—Waukesha County, NDB RWY 28, Amdt. 2

. . . Effective April 6, 1989

Wiscasset, ME—Wiscasset, NDB RWY 25, Amdt. 4
Grand Island, NE—Central Nebraska Regional, LOC/DME BC RWY 17, Amdt. 8
Grand Island, NE—Central Nebraska Regional, ILS RWY 35, Amdt. 8
Kenosha WI—Kenosha Muni, NDB RWY 6L, Orig.
Kenosha WI—Kenosha Muni, ILS RWY 6L, Orig.

. . . Effective March 1, 1989

Atlanta, GA—Fulton County Airport-Brown Field, ILS RWY 8, Amdt. 14

. . . Effective February 28, 1989

Mesquite, TX—Phil L. Hudson Muni, LOC RWY 17, Amdt. 1
Mesquite, TX—Phil L. Hudson Muni, NDB RWY 17, Amdt. 2

. . . Effective February 21, 1989

Bangor, ME—Bangor Intl, VOR/DME RWY 33, Amdt. 6

. . . Effective February 16, 1989

Hyannis, MA—Barnstable Muni-Boardman/Polando Field, VOR RWY 6, Amdt. 4

[FR Doc. 89–5629 Filed 3–10–89; 8:45 am]
BILLING CODE 4910–13–M

FEDERAL TRADE COMMISSION

16 CFR Part 456

Trade Regulation Rule; Ophthalmic Practice Rules

AGENCY: Federal Trade Commission.
ACTION: Final Trade Regulation Rule.

SUMMARY: The Federal Trade Commission issues a final rule that removes restraints imposed by state law on certain specified forms of commercial ophthalmic practice. The Commission has concluded that these restrictions are unfair acts or practices within the meaning of Section 5 of the Federal Trade Commission Act and are appropriately remedied by the Trade Regulation Rule promulgated today. The rule bars four types of state restrictions on commercial practice: (1) Prohibitions on certain forms of lay association with or control over optometric practices; (2) limitations on the number of branch offices which optometrists may own or operate; (3) prohibitions on the practice of optometry in commercial locations; and (4) prohibitions on the practice of optometry under a nondeceptive trade name. The rule also incorporates, with minor technical changes, the prescription release requirement originally promulgated as part of the Trade Regulation Rule on Advertising of Ophthalmic Goods and Services.

Published here are the Rule's Statement of Basis and Purpose, which incorporates a Regulatory Analysis, and the text of the final rule.

EFFECTIVE DATE: September 1, 1989.

ADDRESS: Requests for copies of the Rule and the Statement of Basis and Purpose should be sent to the Public Reference Branch, Federal Trade Commission, 6th Street and Pennsylvania Avenue, NW., Washington, DC 20580.

FOR FURTHER INFORMATION CONTACT: Richard Kelly, Renee Kinscheck, or Patricia Brennan, Division of Service Industry Practices, Bureau of Consumer Protection, Federal Trade Commission, Washington, DC 20580 (202) 326–3304, (202) 326–3287, or (202) 326–3274.

SUPPLEMENTARY INFORMATION:

List of Subjects in 16 CFR Part 456

Eyeglasses, Ophthalmic practice, Trade rules.

By direction of the Commission, Chairman Oliver dissenting.

Donald S. Clark,
Secretary.

Statement of Basis and Purpose

I. Introduction

A. Overview of the Rule

1. *Commercial Practice Restrictions.* Some state-imposed restrictions on the commercial practice [1] of optometry cause significant injury to consumers. While justified as necessary to protect consumers, these restrictions actually work to deprive consumers of necessary eye care, restrict consumer choice, and impede innovation in the eye care industry.

The monetary cost—likely to be millions of dollars annually—is great. Over half of all Americans and more than 90 percent of elderly consumers use corrective eyewear, and over eight billion dollars was spent on eye exams and eyewear in 1983.[2] A significant

[1] Optometric practices range across a continuum from what can be characterized as strictly traditional (e.g., solo practitoner operating in an office building under own name) to highly commercial (e.g., large chain optometric firm, with offices in many states). For purposes of this proceeding, an optometrist is considered to be in "commercial practice" if he or she is associated with or employed by a nonoptometrist, uses a trade name, operates more than a single office, or practices at a mercantile location.

[2] NAOO, H–78, at 7 (figure derived from the annual National Consumer Eyewear study conducted by the Optical Manufacturers Association). The NAOO anticipated that 1985 sales would exceed nine billion dollars.

All documents on the rulemaking record have been given alphanumeric designations based upon the system established by the Presiding Officer. A full explanation of these designations is given at the beginning of Bureau of Consumer Protection.

Continued

proportion of these costs can be attributed to the inefficiencies of an industry protected from competition by state regulation. A study done by the FTC's Bureau of Economics shows that prices for eye care are 18 percent higher in markets where chain firms are totally restricted than in markets where chain firms operate freely.

State restrictions on commercial practice are pervasive. Some restrictions are statutory. Others are found in regulations promulgated by state boards of optometry.[3] This rule declares unfair four specific types of state restrictions on competition among optometrists and other vision care providers:

(1) *Restrictions on Affiliations With Nonoptometrists.* Most states have one or more restrictions on lay affiliations. Such restrictions take many forms, including restrictions on employment of optometrists by business corporations or nonoptometrists, on the forming of partnerships between optometrists and nonoptometrists, on the splitting of optometrists' professional fees with nonoptometrists (which, in effect, can prohibit joint-ownership or equity-participation agreements), and on the forming of franchise agreements and landlord-tenant agreements between optometrists and nonoptometrists, including agreements under which rental payments are based on a percentage of gross revenue.[4] Some states also prohibit such corporate affiliations by prohibiting nonoptometrists from exercising any control over the business aspects of an optometric practice.[5]

(2) *Restrictions on practice in mercantile locations.*[6] Over twenty states impose one or more bans that appear to explicitly prohibit the practice of optometry in mercantile locations. The most common ban explicitly prohibits optometrists from practicing in or leasing space from a retail establishment, such as a department store or optical store. Most states that prohibit optometrists from practicing in a retail establishment permit optometrists to locate in or next to that business only if there is a separate entrance to a public street or hallway, in what is known as a "two-door" or "side-by-side" arrangement. In addition, several states appear to restrict practice in shopping malls.[7]

(3) *Restrictions on branch offices.* Many states restrict the number of offices that an optometrist may own or operate. Some impose flat limitations on the number of offices that an optometrist may open,[8] while others indirectly impose limits by requiring an optometrist to be present a certain percentage of the time a branch office is open.[9]

(4) *Restrictions on the use of trade names.*[10] Trade name restrictions generally take one of three forms. First, some states explicitly ban any use of trade names by optometrists.[11] Second, some states specify that trade names must include certain words.[12] Third, several states require that the names of all optometrists practicing under a trade name or at any advertised location must be disclosed in all advertisements that use the trade name.[13]

As of 1985, at least 44 states had one or more of these four types of restrictions.[14] Thirty-nine states prohibited employer-employee or other business affiliations between optometrists and persons who are not optometrists, including partnerships, joint-ownership or equity-participation agreements, franchise agreements, landlord-tenant agreements, and other similar affiliations. At least 19 states limited the number of branch offices which may be owned or operated by optometrists, often limiting optometrists to one or two branch offices. Thirty states restricted optometrists from practicing in mercantile locations such as shopping malls, department stores, and other retail establishments. At least 32 states prohibited the use of nondeceptive trade names by optometrists. Each of these restrictions prevents or restricts the development of alternatives to the traditional solo practice.

Evidence gathered during a lengthy investigation and an extensive rulemaking proceeding includes two Commission-sponsored surveys, additional survey evidence, and expert economic, testimonial, and documentary evidence. That substantial body of evidence demonstrates that these restrictions raise prices to consumers and, by reducing the frequency with which consumers obtain vision care, decrease the overall quality of care provided in the market. The rulemaking record establishes that the presence of commercial optometric firms lowers the cost of eye care to patients of both commercial and noncommercial optometrists. The evidence also indicates that these restrictions do not provide offsetting quality-related benefits to consumers.

The Commission has concluded that these restrictions are unfair acts or practices within the meaning of section 5 of the Federal Trade Commission Act and are appropriately remedied by the Trade Regulation Rule promulgated today.

2. *Prescription Release.* The rule continues to require that optometrists and ophthalmologists release eyeglass lens prescriptions to their patients upon completion of an eye examination. The Commission considered a staff proposal

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Federal Trade Commission, Ophthalmic Practice Rules: State Restrictions on Commercial Practice, (1986), L–1 (hereinafter referred to as "Final Staff Report"). For example, documents in the H category are written comments filed by providers or sellers of ophthalmic goods or services and by ophthalmic organizations. Documents in the J category are written witness statements, transcripts of the hearings and hearing exhibits. Hearing transcripts, which appear on the rulemaking record as J–71, are cited by page number (e.g., "Tr. 999").

[3] In still other cases, attorney general opinions, judicial interpretations, and board interpretations may reveal restrictions not apparent from the face of the statute or regulation.

[4] The sharing of profits or of gross revenues is an integral part of many of these business relationships. For example, partnership agreements involve distribution of income on a percentage basis. An essential element of franchise agreements is payment of a percentage of gross revenues by the franchisee to the franchiser, often referred to as a "royalty."

[5] Some degree of lay control over the business aspects of a practice is an essential element of these relationships.

[6] As used herein, "mercantile location" refers to shopping malls and to retail establishments such as department stores and optical outlets.

[7] Two states, Rhode Island and Alaska, apparently prohibit shopping mall practices altogether. While Rhode Island's prohibition does not mention shopping malls explicitly, it does bar optometrists from practicing in a building where over 50% of the remaining space is rented under percentage leases. Since such leases are almost universally used in shopping centers, J. Solish, Counsel, R.H. Teagle Corp., Tr. 1371; C. Callsen, NAOO, Tr. 353, the effect of this provision is to inhibit optometric practice in shopping centers. In Alaska, no such ban appears in statute or regulation. However, there is evidence that the Board of Optometry enforces such a restriction. J. Ingalls, President, Western States Optical, J–54, at 3–4.

[8] See, e.g., Ky. Rev. Stat. section 320.310(3) (1983).

[9] See, e.g., Or. Admin. R. section 852–10–030(5) (1984).

[10] The Supreme Court's decision in *Friedman v. Rogers*, 440 U.S. 1 (1979), that a Texas statute prohibiting the use of trade names did not violate the First Amendment, does not preclude a Commission finding of unfairness regarding trade name bans. The Commission applies a different standard for purposes of an unfairness analysis under section 5 of the FTCA.

[11] See, e.g., Fla. Stat. section 463.014(1)(a); Ind. Admin. R.1–4–1(a).

[12] For example, California requires that all trade names contain the word "optometrist" or "optometric." Cal. Bus. & Prof. Code sections 3125 (b) and (c).

[13] See, e.g., Mo Rev. Stat. section 336.200.

[14] See charts in Final Staff Report, L–1, at 33–46, for a detailed breakdown of state regulation of the practice of optometry. The statistics on commercial practice restrictions cited here and elsewhere in the Statement are based on an analysis of state regulatory practice as of 1985. A sampling of state statutes and regulations, as of October 1988, confirmed that one or more of the restraints at issue here continue to exist in a majority of the states

to modify this provision to require that prescriptions be released only upon request. After weighing the evidence, we conclude that there is a continuing need for the "automatic release" component of the requirement. However, technical changes have been made in the rule language in order to make clear that this provision is directed only at prescriptions for eyeglass lenses and creates no obligation concerning the release of prescriptions for contact lenses.

B. History of the Proceeding.

This proceeding grew out of an investigation begun in 1975 into state and private restraints on advertising of ophthalmic goods and services. The first phase of the investigation culminated with the promulgation in 1978 of the Trade Regulation Rule on the Advertising of Ophthalmic Goods and Services.[15] As the investigation progressed, the staff began to accumulate evidence that restrictions on advertising were not the only public restraints that appeared to limit competition, increase prices, and reduce the quality of eye care provided to the public. The second phase of this inquiry focused on the commercial practice restrictions described above.

To obtain further evidence on these issues, staff conducted two comprehensive studies. The first, published in 1980 by the Bureau of Economics, compared the price and quality of optometric services in restrictive and nonrestrictive markets.[16] The second study, published in 1982 by the Bureaus of Consumer Protection and Economics, compared the price and quality of cosmetic contact lens fitting services of commercial optometrists and other provider groups.[17] At the same time, the staff conducted a study measuring compliance with the prescription release requirement of the Eyeglasses Rule.[18]

In July 1980 staff published the results of its investigation on commercial practice restrictions in an initial staff report.[19] Based on this report and other evidence gathered, the Commission published an Advance Notice of Proposed Rulemaking ("ANPR") in December 1980, that requested comments on the issues presented by the investigation and on what action, if any, the Commission should take.[20]

Based on the survey evidence, the initial staff report, and the comments received in response to the ANPR, the Commission published on January 4, 1985, a Notice of Proposed Rulemaking initiating this rulemaking proceeding ("Eyeglasses II").[21] During the proceeding, 243 written comments were received: 12 from consumers and consumer groups; 159 from optometrists, sellers of ophthalmic goods, and their professional associations; 69 from federal, state, and local government officials; and 3 from members of the academic community. Ninety-four persons testified during three weeks of public hearings.[22] Twenty-four rebuttal comments were filed in response to that testimony.

The staff reviewed the entire record and published its final report in October 1986.[23] The report recommended the promulgation of a rule that would eliminate the four types of commercial practice restrictions described above and modify the prescription release provisions in the Eyeglasses Rule. The Presiding Officer's Report, released in December 1986,[24] recommended against adopting a rule that would proscribe commercial practice restrictions, and also recommended against modifying the prescription release requirements of the Eyeglasses Rule. After review of these comments, the staff submitted its final recommendations to the Commission in July 1987.[25]

On November 5, 1987, the Commission heard oral presentations from several rulemaking participants who had asked to present their views directly to the Commission as provided in § 1.13(i) of the Commission's Rule.[26] The Commission met on February 10, 1988, and voted to promulgate a rule that prohibits four specified types of state bans on commercial practice and retains the prescription release requirement from the original Eyeglasses Rule.

II. Factual Basis for the Rulemaking

A. Evidentiary Standards for an Unfairness Rulemaking [27]

The Commission requires that a preponderance of the evidence support the factual propositions underlying a determination that an existing act or practice is legally unfair. Before promulgating an unfairness rule the Commission requires answers to the following questions: (1) Is the act or practice prevalent? (2) Does the act or practice injure consumers? (3) Is the proposed rule likely to reduce that injury? (4) Is the injury to consumers outweighed by countervailing benefits that flow from the act or practice at issue? and (5) Can consumers reasonably avoid the injury? [28]

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[15] 16 CFR Part 456 (hereinafter cited as "Eyeglasses Rule"). The Commission found public and private bans on nondeceptive advertising by vision care providers and the providers' failure to release eyeglass lens prescriptions to be unfair acts or practices in violation of section 5 of the FTC Act. The rule prohibited bans on nondeceptive advertising and required vision care providers to furnish copies of prescriptions to consumers after eye examinations. Subsequently, the U.S. Court of Appeals for the District of Columbia in *American Optometric Association v. FTC*, 626 F.2d 896 (D.C. Cir. 1980), upheld the prescription release requirement but remanded the advertising portions of the Eyeglasses Rule for further consideration in light of the Supreme Court decision in *Bates v. State Bar of Arizona*, 433 U.S. 350 (1977). After further consideration, the Commission has addressed the few remaining advertising restrictions through administrative litigation rather than rulemaking.

[16] Bureau of Economics, Federal Trade Commission, Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry (1980), B–2–31 (hereinafter cited as "BE Study"). That study showed that commercial practice restrictions resulted in higher prices for eyeglasses and eye examinations, but did not increase their quality.

[17] Bureaus of Consumer Protection and Economics, Federal Trade Commission, A Comparative Analysis of Cosmetic Lens Fitting by Ophthalmologists, Optometrists, and Opticians (1983), B–5–1 (hereinafter cited as "Contact Lens Study"). That study showed that commercial optometrists charged significantly lower prices for fitting cosmetic contact lenses and fitted such lenses at least as well as other fitters of contact lenses.

[18] Market Facts Public Sector Research Group, FTC Eyeglasses Study: An Evaluation of the Prescription Release Requirement (1981) (hereinafter cited as "Market Facts Study").

[19] Bureau of Consumer Protection, Federal Trade Commission, State Restrictions on Vision Care Providers: The Effect on Consumers (1980), B–2–1 (hereinafter cited as "1980 Staff Report").

[20] 45 FR 79,823 (1980). During the 60-day comment period, 247 comments were received.

[21] 50 FR 598 (1985).

[22] Some organizations sponsored several witnesses; 74 organizations or individuals presented testimony.

[23] Final Staff Report, *supra* note 2.

[24] James P. Greenan, Presiding Officer, Report of the Presiding Officer on Proposed Trade Regulation Rule of Ophthalmic Practice Rules (1986), L–2 (hereinafter cited as "Presiding Officer's Report").

[25] Bureau of Consumer Protection, Federal Trade Commission, Ophthalmic Practice Rulemaking: Final Recommendations (July 31, 1987), O–1(b) (hereinafter cited as "Staff's Final Recommendations").

[26] The participants were: The American Optometric Association (hereinafter cited as the "AOA"); The California Optometric Association (hereinafter cited as the "COA"); The National Association of Optometrists and Opticians (hereinafter cited as the "NAOO"); The Opticians Association of America; The American Association of Retired Persons; U.S.A. Lens, Inc.; and 20/20 Optical.

[27] See infra section III. A. for a discussion of the statutory basis and evolution of the Commission's unfairness authority.

[28] *American Financial Services Ass'n v. Federal Trade Commission*, 767 F.2d 957, 971 (1985); Rule on Sale of Used Motor Vehicles, Statement of Basis and Purpose, 49 FR 45692, 45703 (1984); Credit Practices Rule, Statement of Basis and Purpose, 49 FR 7740, 7742 (1984); Letter from Federal Trade Commission to Senators Wendell H. Ford and John C. Danforth (Dec. 17, 1980) (hereinafter cited as "Unfairness Statement"). In issuing the Credit Practices Rule, the Commission acknowledged that the evidence necessary to answer these questions will vary depending on the circumstances of each rulemaking and the characteristics of the industry involved. 49 FR 7740, 7742 n. 4.

As a matter of policy, the Commission has set an even higher standard for promulgation of a rule that directly challenges state law. Out of deference to the principles of federalism, the Commission will take such action as a remedy of last resort, appropriate only if substantial consumer injury is clearly shown; the benefits of the state laws are minimal or absent; and the states are not acting on their own to change the laws.[29]

In this proceeding, the record clearly supports affirmative answers to each of the above-mentioned questions. First, at least 44 states have one or more of the four types of restrictions at issue here. Second, comprehensive and reliable evidence shows that the restrictions cause significant harm to consumers by increasing prices and reducing the frequency with which consumers obtain care. Third, by declaring that such restrictions are unfair, the rule removes such restrictions and thereby eliminates the harm to consumers. Fourth, comprehensive and reliable evidence indicates that the restrictions do not provide consumer benefits since they fail to increase the quality of care received by consumers. Fifth, consumers cannot avoid the adverse effect of these state-imposed and state-enforced restrictions.[30]

The Commission has a responsibility to see that the best evidence reasonably available is included on a rulemaking record before promulgating a rule.[31] The best evidence will often be surveys or other methodologically sound quantitative analyses. The Commission may also consider other reliable evidence and expert testimony.

The quantity and quality of evidence in this proceeding supports promulgation of the rule under standards set by the Commission and the courts. The need for the rule is demonstrated by the BE and Contact Lens Studies.[32] The rule is further supported by additional studies, by documentary and testimonial evidence, and by the absence of any substantial or persuasive contrary evidence. The cumulative impact of this evidence persuades us that the rule is necessary and will provide substantial benefits to consumers.

[29] Letter from Federal Trade Commission to Senator Robert Packwood, Chairman, Committee on Commerce, Science and Transportation, United States Senate (March 5, 1982).

[30] See infra section VI.A.

[31] Trade Regulation Rule on Sale of Used Motor Vehicles, Statement of Basis and Purpose, 49 FR 45692, 45703 (1984); Credit Practices Rule, Statement of Basis and Purpose, 49 FR 7740, 7742 (1984).

[32] See infra section II.D. for a detailed discussion of the methodology used in these studies.

B. Evidence Regarding Harm to Consumers Caused by Commercial Practice Restrictions.

1. *Higher Prices.* The evidence on the record demonstrates that commercial practice restrictions raise prices for eye care goods and services.[33] By impeding competition from commercial firms, the restrictions result in higher average prices for both commercial and traditional practitioners and at all levels of quality. This conclusion is supported by a preponderance of the evidence, which shows: (1) That average prices for eye exams and eyeglasses are lower in markets with chain firms than in markets without chain firms; (2) that chain firms and other large-volume providers charge significantly lower prices than noncommercial providers; and (3) that each of the restrictions imposes unnecessary costs on commercial practice that impede its development and raise prices to consumers. No reliable evidence contradicts these conclusions.[34]

The BE Study found that prices for eye exams and eyeglasses were 18% higher in markets without chain firms than in markets with chain firms. In markets with chain firms, both traditional and commercial optometrists charged lower prices, and prices were lower at all levels of quality.[35] An earlier study by Professors Lee and Alexandra Benham also concluded that prices of eyeglasses were substantially higher in states with restrictions than in states without restrictions.[36]

Additional evidence demonstrating that commercial firms—generally chain firms or other large-volume providers—charge significantly lower prices for equivalent quality goods and services than noncommercial optometrists includes: (1) The Contact Lens Study, which found that commercial optometrists charged significantly less for cosmetic contact lens fitting than noncommercial optometrists; [37] (2) a survey submitted by the California Optometric Association, which found that chain optometric firms charged less for eye exams than private optometrists; [38] and (3) extensive documentary and other evidence demonstrating that large-volume providers frequently take advantage of economies of scale to charge lower prices for equivalent goods and services.[39]

Finally, as summarized below, the record demonstrates that each of the specific restrictions at issue here imposes unnecessary costs on optometric providers and hinders the development of high-volume practices, resulting in fewer such firms in the market, higher prices to consumers, and decreased access to eye care.

While the studies on the record do not separately describe the effects of each particular commercial practice restriction, the record contains an abundance of other evidence that supports a Commission finding that each of the four types of restrictions inhibits or restricts the formation and expansion of high-volume optometric practices.[40] In addition, the record establishes how the restrictions decrease efficiency and increase prices for volume practitioners that manage to enter the market in spite of the restrictions.

(1) Restrictions on lay associations prohibit optometrists from obtaining capital from nonoptometrists by entering into partnerships, joint ownership agreements or other associations with such persons or entities, a constraint which inhibits capital development. This, in turn, impedes the development of large-scale practices that can take advantage of volume purchase discounts and other economies of scale.[41] These

[33] See Final Staff Report, L-1, at 157-178.

[34] Id. at 165-178.

[35] Id. at 101-107.

[36] Benham and Benham, *Regulating Through the Professions: A Perspective on Information Control*, 18 J. L. & Econ. 421 (1975), B-2-29. See Final Staff Report, L-1, at 164 for a further discussion of the Benhams' study. In the 1980 Staff Report and the Final Staff Report, staff acknowledged several potential methodological shortcomings with the Benham data which indicate that the study, standing alone, would not be sufficient to support this rulemaking. Final Staff Report, L-1, at 165; 1980 Staff Report, B-2-1, at 46, 58-59. Despite these potential shortcomings, the record indicates that the Benham data provides useful information to corroborate the findings of the BE Study. Final Staff Report, L-1, at 164-165. See also 1980 Staff Report, B-2-1, at 58-59.

[37] The results showed that commercial optometrists charged prices that were on average 20% lower than noncommercial optometrists and over 30% lower than ophthalmologists.

[38] Consumer Study of Optometric Practices in Metro-Atlanta Area, J-67(a) (Attachment to Statement of California Optometric Ass'n) (hereinafter cited as "Atlanta Survey"). The survey was conducted by John H. Thomas and Associates, Atlanta, Georgia. See Final Staff Report, L-1, at 161-163 for a further description of this survey.

[39] For example, in 1982, the California Department of Consumer Affairs estimated that the cost differences attributable to economies of scale during the first 10 years of practice between an independent solo practitioner and a corporation could range from $12 to $13 per customer. Department of Consumer Affairs, State of California, Commercial Practices Restrictions in Optometry 8-11, 13 (1982), J-24(b). See also Final Staff Report, L-1, at 59-67, 177-178.

[40] See Final Staff Report, L-1, at 49-100.

[41] The record indicates that the use of volume discounts by high-volume practices can reduce significantly the costs of equipment, material, and supplies. For example, the NAOO stated that through the use of volume discounts, an office could

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restrictions contribute to higher prices by excluding or deterring volume practitioners from entering the market and by preventing practitioners in the market from operating at the most efficient level.[42]

(2) Restrictions on practicing in mercantile locations, such as department or drug stores, also raise prices to consumers by inhibiting the formation of high-volume commercial practices. Mercantile locations, which are generally more convenient to consumers, generate a high volume of consumer traffic. Restrictions on practicing in mercantile locations may also impose unnecessary space, construction, or personnel costs that must be passed on to consumers.[43] These burdens fall both on optometric chain firms and on individual practitioners.

(3) Restrictions on branch offices create barriers to expansion both by individual optometrists and by lay optometric firms. These restrictions reduce the total volume of patients that a practice might otherwise be able to serve. This reduced volume of patients prevents optometrists from taking advantage of economies of scale that arise from volume purchasing discounts and reduced per office advertising costs. Also lost are the potential savings that multi-branch practices may achieve through more efficient management techniques.[44]

(4) Bans on trade name practice and advertising deprive consumers of valuable information and increase consumer search costs. Trade names are of value to consumers because, over time, the names come to reflect the cumulative experience that consumers have had with a particular firm. As a result, trade names are a valuable asset to firms, and restrictions on their use hinder the growth and development of optometric firms. Trade name bans also make it difficult for high-volume operators to advertise multiple outlets and to allocate advertising expenses over those outlets.[45]

The record also establishes [46] that state laws which require that all trade name advertisements include the names of all optometrists practicing at a given advertised location or practicing under the advertised trade name effectively ban much nondeceptive trade name advertising. Thus these restrictions have a similar detrimental effect on consumers as outright bans on trade name usage and advertising.

Many states have enacted more than one of these restrictions.[47] While each of these restrictions may impede the growth and efficiency of chain firms or volume practices, a combination of restrictions may completely bar their entry.

The Presiding Officer also found that the record demonstrated that prices for optometric goods and services are significantly lower in nonrestrictive markets than in restrictive markets.[48] Commenters did not seriously dispute the evidence that large-volume practitioners can achieve economies of scale unavailable to smaller practitioners,[49] nor did they submit any reliable studies that contradicted the price findings of the BE and Contact Lens Studies.[50]

2. *Less Care.* Commercial practice restrictions harm consumers not only by raising prices but also by decreasing the overall quality of care received by consumers. The record evidence indicates that, as a result of the higher prices in restrictive markets, consumers obtain eye care less frequently than they otherwise would.[51] Some consumers

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be equipped for about two-thirds of the standard retail price. Moreover, materials such as frames and lenses can be discounted as much as 25% when purchased in volume. See Final Staff Report, L–1, at 60–61.

[42] Id. at 57–67.

[43] For example, in those states that mandate a two-door or side-by-side arrangement, optometrists typically must maintain an office that is separate from the optical dispensary and that also has a separate entrance to a public street, corridor, or hallway. This results in higher construction costs, requires more space and thus more rent, and increases frontage costs.

The NAOO estimates that the cost of constructing, equipping, and fixturing a side-by-side office is 15–20% higher than for an equivalent one-door office. NAOO, H–78, at 35. This cost, which typically might amount to $10,000 per office, includes duplicating the heating, cooling, bathroom, waiting room, and other facilities. See also Final Staff Report, L–1, at 84–88.

[44] For example, branch office restrictions may prevent optometric firms from employing or entering into other business relationships with optometrists at more than the permitted number of locations. NAOO, H–78, at 60. Each office that the optometrist is scheduled to work in is considered a branch for purposes of these restrictions, so that firms cannot schedule an optometrist to practice in more than the permitted number of locations. This may prevent these firms from efficiently distributing their optometrists to best meet the needs of the firms' various offices. See Final Staff Report, L–1, at 74–77.

[45] See Final Staff Report, L–1, at 95–97.

[46] The evidence shows that the cost of disclosing the names of all optometrists practicing under a trade name is so burdensome as to preclude the effective use of trade names under many circumstances. Similarly, the cost of disclosing the names of all optometrists at particularly advertised locations effectively prevents nondeceptive trade name usage in such advertisements under some circumstances. See NAOO, H–78, at 84–87. G. Black, Arkansas Retail Merchants Ass'n, D–1 at 2; P. Zeidman, Counsel, International Franchise Ass'n, Tr. 617–620; NAOO Panel, Tr. 538; and Final Staff Report, L–1, at 88.

[47] At least 28 states have at least three of these restrictions. *See* charts in Final Staff Report, L–1, at 33–46.

[48] Presiding Officer's Report, L–2, at 182–186.

[49] Some commenters pointed to limited instances in which smaller-volume practitioners may achieve economies of scale. *See* e.g., Reponse of the COA to Dept. of Consumer Affairs Report, K–12, at 6 (attachment to Rebuttal of the COA) and Post-record comment of AOA, M–176, at 454. However, even if small discounts are available to small-scale practitioners, that does not contradict the fact that larger discounts may be available to high-volume practitioners.

[50] See Final Staff Report, L–1, at 165–171. Some survey evidence was presented by the COA and the AOA that ostensibly showed that commercial firms do not charge less and may even charge more than noncommercial optometrists. For instance, the COA claimed that the Atlanta Survey's findings on "mark-ups" showed that "alleged corporate efficiencies (*e.g.*, savings through volume discounts) were not being passed on to consumers" because all the provider groups had equivalent "mark-ups" on materials. However, this "mark-up" data provided no useful insight into the relative prices charged by the different provider groups because of considerable variation in the wholesale costs of the frames and lenses purchased for the survey. *Id* at 165–68. The AOA also attempted to rely on some data from a *20/20* magazine survey showing that average billings were higher for optometric practices with annual sales greater than $200,000 a year than for practices with lower annual sales. However, this survey fails to provide meaningful data about differences between chain and nonchain firms. *Id.* at 169–170. It also fails to provide meaningful data about differences between low-volume practices and high-volume practices, as that term has been used in this proceeding—*i.e.*, multi-optometrist, multi-office practice. See Rebuttal Statement of R. Bond, FTC economist, L–18, at 15 n. 6. As explained by the author of the *20/20* article, each group (both over $200,000 and under $200,000) most probably includes both chain and independent operations. It is unclear whether the reported gross sales volume refers to per-office volume or per-company volume. If the data is *per-office* gross sales, the data cannot be used to distinguish low-volume firms from those with a significantly larger volume since large chains may have per-office volume above or below $200,000, while private practitioners may also be in either category. (This data was calculated based upon figures in Rebuttal Statement of NAOO, H–78a, at 11 and in Ophthalmic Practice Rulemaking Statement and Exhibits—Robert R. Nathan Associates, Inc., J.–66(A), at Vol. II, Ex. 1, Appendix E at E–3 (hereinafter referred to as "Nathan Study"). If the data is *per company*, $200,000 is too low a figure to provide a meaningful distinction between high and low volume. Many solo practitioners have this volume, but some chain firms have annual sales in the billions. Further, the *20/20* article noted that in this sample, more smaller practices advertised than larger ones; only 40 percent of larger practices advertised. "One probable reason would be the infrequent advertising of many large ophthalmological and optometric practices which still deem advertising to be unprofessional." *20/20* Article; Nathan Study, J–66(a) at Vol. II, Ex. II, Appendix E, at E–2, E–6. This indicates that many traditional private practitioners and small group practices were included in the "over-$200,000" group.

[51] Professors James Begun and Lee Benham stressed the importance of frequency of eye care as an aspect of quality and stated that there can be little doubt that the restrictions result in reduced frequency of vision care purchases. *See* J. Begun, Professor, Virginia Commonwealth University, K–1,

Continued

forego eye care entirely, while others delay the purchase of eyeglasses and eye exams.

Evidence of the rulemaking record shows that some consumers are not obtaining adequate vision care because of financial circumstances. Testifying in favor of Medicare coverage for eye care, the AOA told a Congressional committee in 1976 that many elderly persons go without adequate vision care because of its cost.[52] In that Congressional testimony, the AOA also provided evidence that uncorrected vision problems can lead to serious injury to older consumers. According to the AOA, 85 percent of all serious injuries sustained by persons 65 and older are caused by falls; 25 percent of these relate directly to uncorrected vision problems.

Survey evidence also demonstrates that higher prices result in reduced purchases of eye care. Based on the results of an extensive nationwide survey, Professors Lee and Alexandra Benham found that significantly fewer individuals purchased eyeglasses in a given year in states with higher prices than in states with lower prices.[53] In 1979, a survey of 1,254 families sponsored by General Mills found that families had cut back on annual medical checkups, new eyeglasses, dental treatment, and various preventive health care services because of inflation.[54] Finally, Public Health Service data indicate that annual purchase and repair of eyeglasses increases with family income.[55] This evidence indicates that economic considerations influence vision care expenditures, and that people are likely to cut back such expenditures as prices rise.

Very few proponents of the restrictions addressed the question of the frequency of eye care purchases. While some pointed to alleged shortcomings of the survey data discussed above, none of the alleged shortcomings prevent the Commission from concluding that commercial practice restrictions, which raise the price of eye care, lead to reduced purchases of eye care.[56]

A few commenters did state that no one is going without eye care since special assistance is available for the indigent.[57] However, no evidence was presented by these commenters to indicate how extensive such programs are or under what circumstances they would apply. Moreover, these commenters did not address the point that consumers not eligible for such assistance programs may be delaying or rationing purchases because of higher prices. On the other hand, we find persuasive the testimony of consumer groups that all but the poorest consumers must pay for vision care out of their own pocket without reimbursement by public assistance or private insurance.[58] A study by the Optical Manufacturers Association demonstrated that only 10–20 percent of all expenditures for eye examinations, eyeglasses, and contact lenses is paid for by insurers or other third-party payors. The remaining 80–90 percent is paid directly by the patient.[59]

Commercial practice restrictions also affect consumers' access to vision care by restricting the places where an optometrist may locate. The record indicates that commercial optometrists may be more conveniently located [60] and may be more frequently available on weekends and evenings.[61] These are additional reasons why restrictions on such firms tend to reduce accessibility and the frequency of purchase of vision care.

C. Countervailing Benefits of Commercial Practice Restrictions

The stated justification for commercial practice restrictions is that they are necessary to maintain high-quality vision care.[62] If this assertion were true, one would expect to find higher quality care in those markets where commercial practice is prohibited or limited. But the record is quite clear on this central issue: There is no difference in the average quality of care available to consumers in restrictive and

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Exhibit 12 (Attachment to Rebuttal Statement of NAOO); Rebuttal Statement of Lee Benham, Professor, Washington University, K–17, at 2; A. Beckenstein, Professor, University of Virginia, at A–7 (Appendix A to Rebuttal Statement of NAOO). Consumers Union stated that removal of the restrictions will allow more frequent eye exams and improve patient health because more consumers will be able to afford the vision care and eyeglasses they need. H. Snyder, West Coast Director, Consumers Union, J–24(a) at 2, citing, State of California, Department of Consumer Affairs, Commercial Practice Restrictions in Optometry (1982), J–24(a), at Exh. A at iii (Attachment to Statement of Consumers Union).

[52] Medical Appliances for the Elderly: Needs and Costs, Hearings Before the Subcomm. on Health and Long-term Care of the House Select Comm. on Aging, 94th Cong., 2d Sess. 155 (1976) (Statement of the AOA), B–2–36.

[53] Benham and Benham, *Regulating Through the Professions: A Perspective on Information Control*, 18 J.L. & Econ. 421, 438 (1975), B–2–29. This survey consisted of interviews with 10,000 individuals in 1970. The sample was drawn to overrepresent elderly individuals and individuals living in inner cities and in rural areas. Id. at 428.

[54] Forty-eight percent of families said that they had cut back on such expenditures as a result of inflation; 56% of low-income families, 60% of minorities and 72% of single parents made this statement. M. Kernan, *U.S. Health Profile*, Washington Post, Apr. 28, 1979, B–2–37, at C–1, col. 4.

[55] Data for 1977 indicated that there was a 25% increase in the number of persons who purchased or repaired eyeglasses in that year as family income increased from less than $12,000 to $25,000 or more per year. Public Health Service, U.S. Dept. of Health and Human Services, National Health Care Expenditures Study, Eyeglasses and Contact Lenses: Purchases, Expenditures, and Sources of Payment 4 (1979), G–14.

[56] For example, some commenters criticized the methodology of the Benhams' survey and claimed that none of the surveys showed that commercial practice restrictions caused reduced eye care purchases. See Post-record comment of AOA, M–176, at 422–33. See also Nathan Study, J–66(a), Vol. I, Exh. 1, at 89 n. 1. However, we are not persuaded that the alleged flaws in the Benhams' survey undercut the findings that, in general, higher prices of eye care lead to reduced consumer purchases. *See* Staff's final Recommedations, 0–1(b), at 12–14. While the AOA acknowledged that the surveys showed that inflation, recession, and available income affect consumer decision-making, it claimed that the surveys did not show that commercial practice restrictions, in particular, result in reduced purchases of eye care. However, because these surveys show that, in general, higher prices of eye care lead to reduced consumer purchases and because other evidence on the record shows that commercial practice restrictions lead to higher prices in the market, we can conclude that commercial practive restrictions result in reduced purchases of eye care.

[57] See, e.g., Nathan Study, J–66(a), Vol. I, Ex. 1 at 109–110; J. Moye, Mississippi Optometrist, Tr. 428–29; J. Robinson, Secretary, North Carolina Board of Optometry, Tr. 3001.

[58] See, e.g., H. Snyder, West Coast Director, Consumers Union, J–24(a), at 2 and Tr. 1059–60; J. Denning, President-elect, American Ass'n of Retired Persons, Tr. 60; E. Eggan, Director, American Ass'n of Retired Persons, J–37(a), at 6. Medicare does not, in general, cover vision care.

[59] Optical Manufacturers Association, National Consumer Eyewear Study III (1984), cited in NAOO, H–78, at 2.

[60] See NAOO, H–78, at 4.

[61] Id. at 3; NAOO Panel, Tr. 383–84.

[62] We note that the majority of states where commercial practices exist did not testify in this proceeding. Many of these states submitted written comments, but did not allege abuses by commercial firms. See, e.g., G. Owen, Speaker of Michigan House of Representatives, E–3; L. Clarke, Executive Secretary, New York State Board of Optometry, E–6; S. Rimmiler, Executive Director, Missouri State Board of Optometry, E–9; B. Nichols, Secretary, Wisconsin Department of Regulation and Licensing, E–37. Some of these commenters supported promulgation of the proposed rule.

There is no apparent a priori reason why one would expect these restrictions on business practices to affect the quality of professional care. Both commercial and noncommercial optometrists have similar educational qualifications and must pass the same licensing examinations in order to practice. Commercial optometrists face the same incentives as noncommercial optometrists to satisfy consumer demand and provide an acceptable level of quality eye care. Private optometrists, like commercial firms, must earn a profit in order to stay in business and both types of practitioners seek to generate profits by selling eyewear. Practitioners in both groups must maintain a good reputation in order to attract and hold the loyalty of patients.

nonrestrictive markets.[63] Our conclusion that commercial practice restrictions do not increase the average quality of care provided [64] is based primarily on the results of the BE Study, and is also supported by the Contact Lens Study and by the absence of any substantial and reliable contrary evidence.

The BE Study compared eye care quality in markets with and without chain firms and found that the overall level of quality of eye care was not lower in markets where chain firms were allowed to operate.[65] The study provides reliable evidence covering major areas of eye care provided by optometrists, including the accuracy of prescriptions, the accuracy and workmanship of eyeglasses, the extent of unnecessary prescribing, and the ability to detect eye problems and pathologies.[66] The study found that there was no significant difference in any of these aspects of quality between markets with chain firms and those without chain firms.[67]

The BE Study did find significant variation in the extensiveness of eye examinations provided by optometrists in both restrictive and nonrestrictive markets. The evidence shows that an equal percentage of optometrists provide more extensive exams and less extensive exams in both types of markets.[68] In nonrestrictive markets, commercial optometrists, on average, provide more of the less extensive exams than noncommercial optometrists. In restrictive markets, where all optometrists are by definition noncommercial optometrists, an equal percentage of optometrists provide less extensive exams. These optometrists, like the commercial optometrists, provide less costly and less extensive exams, although their prices are significantly higher than those of the commercial optometrists in nonrestrictive markets.

These findings demonstrate that commercial practice restrictions do not affect the distribution of quality within a given market. Other factors such as the forces of supply and demand are most likely responsible for this distribution. At most, the evidence suggests that there is a group of optometrists in both types of markets that will meet the demand for lower-cost, less-extensive exams. Where commercial practice is restricted, noncommercial optometrists meet that demand, but charge higher prices than commercial practitioners in nonrestrictive markets. Even though commercial firms may, on average, provide less extensive exams than those provided by noncommercial optometrists in nonrestrictive markets, the overall quality of care is no lower in those markets.[69]

The findings of the BE Study on quality of care are supplemented by the Contact Lens Study's conclusion that, on average, commercial optometrists fitted cosmetic contact lenses at least as well as noncommercial optometrists.[70]

Proponents of the restrictions offered no evidence on differences in quality between restrictive and nonrestrictive markets, but instead attempted to show that commercial optometrists provide lower quality of care than noncommercial optometrists.[71] Much of this evidence was anecdotal and was often countered by other anecdotal testimony concerning poor quality of care provided by noncommercial optometrists.[72]

Moreover, the survey evidence that was presented by proponents of the restrictions was unreliable. The Nathan Study, commissioned by the AOA, was offered as evidence of quality differences between commercial and noncommercial optometrists in one market.[73] However, that study failed to employ generally accepted and recommended survey techniques in order to guard against bias. The record indicates that the procedures used created a significant potential that the bias of AOA representatives who were substantially involved in the survey could have affected the results. This renders the survey unreliable.[74] Furthermore, by focusing on only one market, the Nathan Study fails to address the central issue of whether there is a difference in overall quality between restrictive and nonrestrictive markets. Even if we were to assume that the evidence on quality presented by proponents of the restrictions were reliable or convincing, it would not contradict the findings of the BE Study that there is no difference in the quality of care between restrictive and nonrestrictive markets.[75]

D. Methodology of the BE and Contact Lens Studies.[76]

The findings of the BE and Contact Lens Studies are central to the Commission's conclusions that these restrictions injure consumers and diminish overall quality of care by limiting access to care. The studies drew a great deal of comment, both supportive and critical.[77] In discussing the significance of the comment on the studies, we will first describe the key components of each study, summarize the major points raised by commenters, and explain why we believe these studies provide the best evidence reasonably available on the quality of care and a sufficiently reliable and comprehensive evidentiary basis for this rule.

1. *The BE Study.* The BE Study was designed to measure the effects on consumers of commercial practice restrictions. The study was conceived and conducted by the Bureau of

[63] See Final Staff Report, L-1, at 108-113 (discussion of BE Study) and 188-206 (discussion of other quality evidence).

[64] In fact, as discussed *supra* at section II.B.2, the restrictions have some adverse effect on quality of care because the higher prices associated with restrictions cause consumers to seek eye care less frequently.

[65] The BE Study is discussed in detail in the Final Staff Report, L-1, at 101-122. See also infra section II.D.1 for a description of the study's methodology.

[66] See infra at section at II.D.1.

[67] See discussion of BE Study in Final Staff Report, L-1, at 112-113.

[68] Id. at 112.

[69] Moreover, the evidence shows that an increasing number of commercial firms are stressing high quality exams. *See* Final Staff Report, L-1, at 202-206. The evidence indicates that some commercial firms, just as some private optometrists, provide very thorough exams and treat a full range of patients, including those with complex problems.

[70] See infra section II.D.2. for a fuller discussion of the methodology of this study.

[71] See citations in Final Staff Report, L-1, at 190-96, 198-201. See also Post-record comment on AOA, M-176, at 400; Post-record comment of COA, M-178, at 5-6; and Presiding Officer's Report, L-2, at 174, 182.

[72] See Final Staff Report, L-1, at 199-206.

[73] In this survey, test subjects with a variety of eye conditions obtained eye examinations from a sample of commercial and noncommercial optometrists in New York City. The purpose of the survey was to determine whether commercial and noncommercial practitioners differed in their ability to detect the eye conditions of the subjects. Nathan reported that 32 percent of the commercial optometrists and 60 percent of the private optometrists detected the eye conditions. According to Nathan, these results showed that eye examinations in New York City given in commercial practice environment tended to be less comprehensive and lower in quality than those given in private practice settings. Nathan Study, J-66(A), Vol. I, Ex. 3, p. 5.

[74] See Final Staff Report, L-1, at 145-56 and Appendix C.

[75] No evidence presented by proponents of the restrictions compared quality of care provided in the two types of markets.

[76] A comprehensive analysis of comments devoted to methodological issues in this proceeding is found in Appendixes A and B of the Final Staff Report, L-1, and in Staff's Final Recommendations, 0-1(b), at 21-49.

[77] The most lengthy and technical of the comments about the studies was submitted by Robert R. Nathan and Associates, a firm of consulting economists hired by the AOA for the proceeding. Nathan's three-volume submission contains both comments on specific aspects of the BE and Contact Lens Studies and the results of a survey Nathan conducted of New York City optometrists in an effort to rebut the quality findings of the BE Study. See supra notes 71, 72. Appendix C of the Final Staff Report, L-1, contains a detailed description of, and expert comments on, the Nathan survey's methodology.

Economics with the expert advice of optometrists on the faculties of two major colleges of optometry (the College of Optometry of the State University of New York and the Pennsylvania College of Optometry) and the Director of the Optometric Service of the Veterans Administration. In the study, nineteen trained survey researchers [78] posed as consumers and purchased over 400 eye exams and over 230 pairs of eyeglasses from optometrists in twelve different metropolitan areas across the country.[79]

The twelve markets represented a range of competitive and regulatory environments. Cities were classified as markets where advertising was present if there was advertising of eyeglasses or eye exams in the newspapers or "Yellow Pages." Cities were classified as markets with commercial practice if eye examinations were available from large optical chain firms.[80]

Based on the data obtained by the survey subjects, the BE Study's authors calculated the average prices charged for an eye exam and eyeglasses [81] by each type of practitioner in each type of market (*e.g.*, chain firms in nonrestrictive markets, nonadvertisers in nonrestrictive markets). Then, using data regarding the number of optometrists of each type in a particular market, the study's authors calculated market-wide average prices for markets with both advertising and chain firms and for markets with neither.[82]

Subsequent to the study's publication, its principal author calculated market-wide average prices for markets with chain firms and markets without chain firms.[83] These calculations showed that the average prices charged by optometrists for eye exams and eyeglasses were 18% higher in markets without chain firms than in markets with chain firms.[84]

BE staff used multivariate regression analysis to analyze the data for: (1) Differences among markets in the advertising environment,[85] (2) differences among markets in the supply of optometrists; (3) differences among markets in the demand for optometric services; and (4) differences among subjects in prescriptive needs. Each of these factors might affect price, independent of the presence of chain firms. The price data were also adjusted for differences in the cost-of-living among cities.[86]

In order to measure any differences in quality between markets with chain firms and markets without chain firms, the study compared: (1) The accuracy of the eyeglass prescriptions; (2) the accuracy and workmanship of the eyeglasses; (3) the extent of unnecessary prescribing; and (4) the ability of the optometrist to detect eye problems and pathologies. Elaborate procedures were established to guarantee an accurate and unbiased assessment of these factors.[87]

On the first three dimensions of quality the study directly examined the optometrist's product or service or "output." For example, the optometrists who acted as consultants for the study performed eye examinations on each survey subject before the subjects went into the field. After examinations, prescriptions, and eyeglasses were obtained by the subjects, the consultants compared those prescriptions and eyeglasses to the prescriptions they had written. The consultants also assessed the eyeglasses for the quality of workmanship—e.g., scratches and imperfections on lenses, the quality of the edging and mounting of lenses, and the quality of materials used.

On the fourth aspect of quality, output was not directly examined. That is, the study did not directly examine whether or not optometrists detected eye pathologies since the study did not use subjects with such pathologies. Instead, the study used a "process" test that indirectly measured the likelihood that an optometrist would detect such pathologies by examining whether the optometrist performed the tests and procedures that are designed to detect complex eye problems and pathologies.

This process test was highly sophisticated and did detect meaningful differences in quality between optometrists. For example, the thoroughness index used in the BE Study included over twenty test procedures as well as other aspects of the examination.[88]

The evidence establishes that the use of this process test provided reliable information about differences in quality of care for two reasons. First, there is a close correlation between the use of a correct process and a correct outcome. During the rulemaking hearings, noncommercial optometrists were virtually unanimous in their assessment that more procedures and more time spent during an eye examination is indicative of a higher quality exam.[89] In fact, some of the same optometrists who criticized the BE Study's use of a process test, nevertheless used the results of that test to demonstrate the alleged differences in quality of care

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[78] With two exceptions, the survey subjects had relatively routine visual problems. Some commenters and the Presiding Officer questioned the study's validity because subjects with more complex problems and pathologies were not included. See Post-record comment of AOA, M–176, at 5–7, 227–230, 382–84; Post-record comment of COA, M–178, at 6, 9–14; and Presiding Officer's Report, L–2, at 176–177.

[79] BE defined the relevant geographical markets as Standard Metropolitan Statistical Areas (SMSA's). The 12 SMSA's were: Little Rock, Arkansas; Knoxville, Tennessee; Providence, Rhode Island; Columbia, South Carolina; Winston-Salem, North Carolina; Milwaukee, Wisconsin; Columbus, Ohio; Portland, Oregon; Baltimore, Maryland; Minneapolis-St. Paul, Minnesota; Seattle, Washington; and Washington, DC.

[80] The "most restrictive" markets in the study had neither advertising nor chain firms; in addition restrictive laws such as those at issue in this proceeding existed in these markets. Cities were classified as "least restrictive" if advertising and chain firms were present. In the least restrictive cities there was price advertising of eyeglasses and at least nonprice advertising of eye exams.

[81] This amount included any dispensing fees, as well as charges for glaucoma tests or any other exam procedures that were priced separately. In order to minimize variations in the eyeglasses frames, subjects were instructed to purchase a particular unisex metal frame, if possible. BE Study, B–2–31, at 46.

[82] BE Study, B–2–31, at 5.

[83] Rebuttal Statement of R. Bond, FTC economist, K–18, at Table A–3.

[84] See Final Staff Report, L–1, at 105.

[85] Some commenters noted that the BE Study did not discuss the independent effects of advertising and chain firms. See, e.g., Nathan Study, J–66(a) at 32, 38–39, 47; AOA, H–81, at 24. However, the BE Study did report that neither advertising nor chain firms had any effect upon quality in a market. Also, while the BE Study did not discuss the independent effects of chain firms and advertising upon price, the study was designed to examine these effects separately. R. Bond, FTC economist, Tr. 466; Rebuttal Statement of R. Bond, K–18, at 5. The separate effects of chain firms were derived by performing a simple calculation on the BE Study's underlying data. See Letter from R. Bond, FTC economist, to J. Greenan, Presiding Officer (May 29, 1985), J–76; Rebuttal Statement of R. Bond, FTC economist, at 5 and Appendix A. See also R. Bond, Tr. 466; J. Kwoka, Professor, George Washington Univ., Tr. 500–01. Dr. Kowka, a coauthor of the BE Study, stated his agreement with Dr. Bond's conclusions and methods of analysis. J. Kwoka, J–12(a), at 9 and Tr. 500–01.

[86] Be Study, B–2–31, at 48–55, 91–93.

[87] See Final Staff Report, L–1, at 108–112.

[88] Thus, we reject the assessment that the process test measured only a very simple and basic process. See Presiding Officer's Report, L–2, at 175; Post-record comment of AOA, M–176, at 227–49; Post-record comment of COA, M–178, at 9, 13. See also discussion in Staff's Final Recommendations, O–1(b), at 34–35.

[89] See, e.g., AOA Comment, H–81, at 42; B. Barresi, Professor, Center for Vision Care Policy, SUNY, J–13(a), at 10; COA Comment, J–67(a), at 4; J. Easton, President-elect, AOA, J–4, at 20; H. Glazier, President, Maryland Board of Optometry, J–21, at 2, Tr. 906, 916; J. Izydorek, optometrist, H–130, at 1; J. Kennedy, optometrist, J–26, at 1; D. Kuwabara, Chairman, Hawaii Board of Optometry, J–34, at 3; Nathan Study, J–66(a), Vol. I, Ex. 2 at 38–40 and Ex. 3 at 17–18; W. Scholl, optometrist, H–124, at 1; J. Scholles, optometrist, AOA trustee, J–31, at 7–8; Southern California College of Optometry, J–41(a), at 1; L. Strulowitz, member, New Jersey Board of Optometry, J–1, at 2; D. Sullins, optometrist, AOA trustee, J–39, at 11;

offered by optometrists in nonrestrictive markets.[90]

Second, the evidence shows that the use of a process test creates no bias in favor of chain firms.[91] Such a bias would exist only if commercial optometrists perform equivalent procedures less competently than other optometrists. In other words, it would have to be shown that any differences in quality were due to differences in competence rather than to differences in time spent and procedures performed. The evidence shows, however, that any differences in quality, if they exist, are likely due to time spent or procedures performed and not due to commercial optometrists performing given test procedures less competently than other optometrists.[92]

The Presiding Officer rejected the quality results of the BE Study. He apparently believed that only an outcome test, using subjects with a wide range of pathologies, would provide reliable evidence. We disagree with this conclusion for two reasons. First, it ignores the BE data discussed above, which permits conclusions about more complex eye problems, and it does not take into account the practical problems presented in conducting a methodologically sound outcome study. Individuals with pathologies in need of immediate treatment could not ethically be used in a lengthy series of field examinations. Finding a large enough sample of individuals who would be suitable survey subjects and who had pathologies not in need of immediate treatment would be prohibitively time-consuming and expensive. Second, there is a significant likelihood that the pathological conditions would change while the survey was being conducted, which would make it impossible to make valid comparisons among the optometrists examining the survey subjects. These obstacles cast serious doubt on the feasibility of conducting an outcome test on this aspect of quality.

The Commission also considered and rejected the assertion that the BE Study would have found that quality was lower in nonrestrictive markets than restrictive markets if its authors had calculated average quality based on the total number of exams given, rather than on number of practitioners. Dr. Kenneth Myers, Director of Optometry Services at the Veterans Administration and a former consultant to the FTC on the BE Study, asserted that the method for calculating average thoroughness of examinations on a market-wide basis was flawed. The BE Study calculated averages by simply averaging the thoroughness scores of all optometrists. Because some optometrists see more patients than others, Dr. Myers believed that the averages should have been weighted to account for the different number of exams performed by individual optometrists. He assumed that such a calculation would lead to a finding of lower average quality in markets with chain firms than the finding reported in the BE Study. However, if one uses Dr. Myers' methodology and his estimate that the typical commercial practitioner performs twice as many exams as the typical noncommercial practitioner, average quality scores for both restrictive and nonrestrictive markets would be lower, but the average score for nonrestrictive markets would still be about the same as that for restrictive markets.[93]

We find that the process test used in the BE Study to evaluate comparative examination thoroughness provides meaningful information about quality of care. Moreover, that test was only one of four factors used to evaluate quality of care. Our conclusions on the quality of care are based on the record as a whole, and not just individual components of any one study.

2. *The Contact Lens Study.* In this study, the eyes of over 500 cosmetic contact lens wearers in 18 urban areas across the country were examined for the presence of seven potentially pathological eye conditions commonly associated with improper contact lens fitting.[94] Each of the survey subjects had been fitted with contact lenses within the preceding three years and was still wearing contact lenses at the time the examinations were performed. The examination procedures were chosen after consultations with representatives of the major eye care professional organizations—the American Academy of Ophthalmology, the American Optometric Association, and the Opticians Association of America.[95] Those organizations also nominated the expert examiners who performed the eye examinations. Three examiners—an ophthalmologist, an optometrist, and an optician—examined each subject.

The examiners were instructed to determine which of the five illustrations of each potentially pathological condition in a grading manual most closely resembled the actual appearance of the subject's eyes. The grading manual, which had been designed by the group representatives, was used to minimize inconsistencies in grading by the several dozen examiners. The examiner then recorded a grade of 0, 1, 2, 3, or 4 for each condition. A grade of 0 meant that the condition was absent; a grade of 4 signified that the condition was present to an extreme degree. The number grades for each of the seven conditions for each eye were combined using a weighing formula to create a "summary quality score" for each subject, which would indicate the overall condition of the subject's eyes.[96]

In addition to analyzing the summary quality scores, the study also examined the relative presence of each of the seven eye conditions individually. A "higher quality" score was assigned if the examination revealed that a particular condition was totally absent (i.e., the grade was 0); a "lower quality" score was assigned if the examination revealed that a particular condition was present to any degree (i.e., the grade was 1, 2, 3, or 4).

In order to compare quality among the different providers, differences in the summary and individual quality scores were computed for commercial optometrists, noncommercial optometrists, opthalmologists, and opticians. Multiple regression estimation techniques were used in order to control

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[90] See e.g., Southern California College of Optometry Panel, J–41(a), at 16; AOA Comment, H–81, at 26; Final Staff Report, L–1, Appendix A at 9 n. 21.

[91] Those commenters who alleged bias in the process test provided no persuasive explanation for that assertion. See AOA Comment, H–81, at 27; Nathan Study, J–68(1), Vol. I, Ex. 1, at 79.

[92] The regression analysis that BE Staff performed on the Nathan survey data indicates that there is no such bias. The analysis found that the commercial firms in the Nathan survey did not exhibit a statistically significant lower pass rate than the private firms, holding constant the time spent on an exam and whether or not a case history was taken. This tends to show that commercial firms perform as well as noncommercial optometrists when they both spend equal time and perform equivalent procedures. See Final Staff Report, L–1, Appendix A at 5–6.

[93] See Staff's Final Recommendations, Addendum to Appendix A, O–1(b), at 8.

[94] These included epithelial and microcystic edema (intercellular accumulation of fluids which causes the cornea to swell); corneal staining (abrasions or lesions on the cornea); corneal neovascularization (impingement of blood vessels into the normally avascular cornea); corneal striae (ridges or furrows on the cornea); injection ("bloodshot" eyes); and corneal distortion or warpage (irregularity in the curvatures of the cornea). The subjects were also tested for visual acuity to determine whether their prescriptions were adequate. Contact Lens Study, B–5–1, at 20–21. Also, subjects' lenses were examined to determine their physical condition and cleanliness.

[95] There is evidence on the record that representatives of all three organizations reached a consensus on the methodology to be used in the study. See Final Staff Report, L–1, at 124 n. 296.

[96] Since all of the seven conditions are not necessarily equally serious, they were assigned different weights based on the relative severity of that condition.

for the effects of a number of factors other than fitter competence that could have affected the relative health of the study subjects' eyes. These additional factors included the wearers' age, sex, and wearing habits, and the physical condition of the lenses.

The survey subjects were also asked how much they paid for their lenses, the eye exam, follow-up care, and the initial lens care kit.[97] The final package price figures were then adjusted for cost-of-living differences in the 18 cities in the sample and to account for the fact that the subjects purchased their lenses in different years.

Two additional tests were later conducted by BE staff on the Contact Lens Study data which demonstrated that these price differences were, in fact, associated with the presence of commercial practice and were not due to the effects of advertising or other market forces that could also affect prices. These tests corroborated the general findings of the study that commercial optometrists charged less than noncommercial optometrists.[98]

The major concerns raised by some commenters about the methodology of the Contact Lens Study were that (1) former contact lens wearers (or "dropouts") were not examined; [99] (2) possible changes in the "k-readings" [100] of the subjects were not evaluated; [101] and (3) study subjects were not required to wear their lenses for at least four hours prior to the examination.[102]

In most instances, the failure to include the specified procedure was unavoidable. For example, consultants and staff wanted to evaluate the care given to former contact lens wearers and to evaluate changes in the k-readings. However, in both instances, the expert consultants could suggest no practical and meaningful way to do so.[103] The testimony of some witnesses suggests that some transient and less significant eye problems might have been more frequently apparent if subjects had been required to wear their lenses for at least four hours before they were examined.[104] But other more serious and long-term conditions do not disappear overnight and would still have been apparent even if a subject had inserted his or her lenses only an hour or two before being examined.

The Presiding Officer and some commenters appear to have concluded that the study's findings must be entirely rejected because of these alleged methodological shortcomings. Although the Contact Lens Study may fail to provide information on some types of patients, or some types of contact lenses, there is no evidence on the record indicating that the study results would have been different had this additional data been included, or that the absence of that data created a bias in favor of commercial optometrists that affected the overall results of the survey.

The BE and Contact Lens Studies provide reliable information about the relative cost and quality of eye care available in the marketplace. We conclude that the evidence provided by the studies—along with other evidence on the record—meets or exceeds the applicable legal standards. In seeking evidence on the need for a rule, the Commission must balance the benefits and costs of obtaining information that answers all questions with certainty.[105] In this proceeding, the studies were subjected to intense scrutiny, but none of the studies' critics offered evidence that materially discredited the studies' key findings. Our confidence in the soundness of the studies is buttressed by consideration of the record as a whole, which contains substantial testimony and economic analysis that support the conclusions of the authors of the BE and Contact Lens Studies.

III. Legal Issues

A. Introduction

A major issue in this proceeding is the extent of the FTC's authority to declare state laws to be unfair acts or practices. After careful consideration of the legal issues discussed below, we have concluded that the FTC can, in appropriate instances, proceed directly against unfair state restraints.

B. Unfairness

This rule declares certain state-imposed restrictions on commercial practice by optometrists to be unfair acts or practices. The Commission has authority under section 18 of the Federal Trade Commission Act to prescribe:

> [R]ules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce [within the meaning of * * * section 5(a)(1)].[106]

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[97] Some commenters noted that the price data collected is based on consumers' recall of the prices that they paid, at times, several years in the past. Nathan Study, J–66(a), Vol. 1, Exh. 2, at 14, 15, and 27. No bias is alleged, however, and there appears to be no reason why consumers would systematically recall paying lower prices at commercial firms than at noncommercial firms. Thus, even if there is some random error in the price data for both commercial and noncommercial optometrists, it would not affect the price differences which were found.

[98] See J. Mulholland, FTC economist, J–19(a), at 7–9, which explains in detail the additional tests which BE staff performed to control for the effect of other variables which could have affected price. See also J. Mulholland, Tr. 794–95.

[99] Presiding Officer's Report, L–2, at 177; Post-record comment of AOA, M–176, at 333–34; Post-record comment of COA, M–176, at 11. This criticism is discussed in the Final Staff Report, L–1, at 135–37.

[100] K-readings, taken with the use of a keratometer, measure the steepest and flattest curvatures of the corneal surface. Contact Lens Study, B–5–1, at 9, 22–23.

[101] Presiding Officer's Report, L–2, at 179, Post-record comment of AOA, M–176, at 315–24. This criticism is discussed in Staff's Final Recommendations, O–1(b), at 44–45.

[102] Presiding Officer's Report, L–2, at 179–180; Post-record comment of AOA, M–176, at 344–359. This criticism is discussed in the Final Staff Report, L–1, at 137–140.

Commenters also listed other alleged problems with the Study, which are discussed in the Final Staff Report, L–1, at 133–44 and in Appendix B. Some commenters stated that the study did not include a representative sample and distribution of difficult contact lens patients and fitting problems and that no difficult cases were included. See, e.g., Post-record comment of AOA, M–176, at 298–300, 302; Post-record comment of COA, M–178, at 14. The fact that the study may not contain a representative distribution of difficult cases does not, however, invalidate the data which the study does provide. While some difficult cases were undoubtedly included in the study, the study did not include an assessment of the relative ability of optometrists to fit more difficult lenses such as therapeutic lenses and the more recently available extended wear lenses, toric lenses, or bifocal lenses. See AOA Post-record comment, M–176, at 102. Also, by excluding patients who had previously worn or attempted to wear contact lenses within three years of the survey date, the study excluded many patients with more difficult eye problems who may have experienced prior problems with their lenses. See Contact Lens Study, B–5–1, at A–1. (Excluding these patients also significantly reduced the possibility of bias which could develop if patients who knew they had difficult eye problems tended to select one group of optometrists over another.) Staff determined that it was impractical to include therapeutic lenses, and other more complex lenses could not be included because they were not available at the time the study was conducted. See Final Staff Report, L–1, at 142–43. However, the failure to study these more difficult cases does not detract from the validity of the data which the study does provide on the relative ability of optometrists to fit the less-difficult cosmetic contact lens patient.

[103] See Staff's Final Recommendations, O–1(b), at 43–45.

[104] Id. at 47 n.166.

[105] Credit Practices Rule, Statement of Bias and Purpose, 49 FR 7740, 7742 (1984). In upholding the Credit Practices Rule, the court recognized the danger in insisting that all of the Commission's conclusions be based on rigorous, quantitative economic analysis, and quoted language from the legislative history of Magnuson-Moss indicating that the Commission is not required to undertake a full-scale economic investigation prior to promulgation of a rule. "To do so would inordinately delay FTC proceedings and deny relief to the consuming public while indefinite questions of economic prediction were resolved by the Commission." *American Financial Services v. FTC*, 767 F.2d 857, 986–87, citing H.R. Rep. No. 1107, 93rd Cong. 2d Sess. 47 (1974). The court quoted language from the legislative history indicating that the Commission should rely on "its best estimate" of the impact of the rule. Id. at 966–87 citing H.R. Rep. No. 1107, 93rd Cong. 2d Sess. 47 (1974), *U.S. Code Cong. & Admin. News* (1974) at 7729.

[106] 15 U.S.C. 57(a)(1)(B).

When Congress created the FTC in 1914 it gave the Commission power to determine and prevent "unfair methods of competition." From the beginning Congress intended this power to be interpreted very broadly.[107] Congress necessarily recognized that it would be impossible to define or even to predict the infinite ways in which the goals of the statute might be thwarted. Consequently, Congress gave the Commission the tools to deal with problems as they developed. Although the original language focused on competition, it was generally understood that the Act "gave the Commission considerable discretion in identifying unfair consumer practices."[108]

The Wheeler-Lea amendments of 1938[109] clarified the FTC's authority to reach acts and practices that injure the public as well as competitors. Those amendments added language to section 5 of the FTC Act to prohibit not only "unfair methods of competition," but also "unfair or deceptive acts or practices."[110] In passing that amendment Congress contemplated that the concept of unfairness would be a flexible doctrine, responsive to changing conditions in the marketplace. The courts have repeatedly recognized the breadth of this delegation and have given the Commission significant latitude in defining unfairness.[111] In its 1980 Unfairness Statement[112] the Commission set out the principles that currently guide the Commission in determining whether acts or practices are unfair.

Those principles were accepted by the D.C. Circuit in upholding the Credit Practices Rule.[113] The court's opinion noted that the consumer injury test described in the Commission's Unfairness Statement was "the most precise definition of unfairness articulated by either the Commission or Congress."[114]

The Unfairness Statement sets out three criteria that must be met in order to find consumer injury: (1) The injury must be substantial; (2) the injury must not be outweighed by offsetting consumer or competitive benefits; and (3) the injury must be one that consumers cannot reasonably avoid.[115] The rulemaking record demonstrates that the injury flowing from state restrictions on the commercial practice of optometry clearly meet these criteria.[116] As summarized *supra* in sections II. B. and C., these restrictions injure consumers by substantially raising the price of eye care, by limiting its accessibility, and by reducing the frequency with which consumers receive it. Further, no demonstrable benefits have been shown to flow from these restrictions, nor can consumers reasonably escape their injurious effect.

Like other rules promulgated under the Commission's unfairness authority, this rule seeks to halt practices that unreasonably create or take advantage of an obstacle to the free exercise of consumer decisionmaking and, in turn, to a well-functioning market.[117] Here, however, the obstacles are created by state governments rather than by private actors. This compels us to consider whether the actions of state governments can be unfair acts or practices.

Through the Magnuson-Moss amendments of 1975 Congress sought to bolster the Commission's existing authority to find acts or practices to be unfair.[118] During consideration of the rulemaking provisions, Congress repeatedly acknowledged that Commission rules would preempt inconsistent state law.[119] The legislative history of Magnuson-Moss reveals that both the sponsors and opponents of the bill recognized the potentially broad reach of the proposed rulemaking authority and contemplated that this power could be used to challenge existing laws directly.[120] A conclusion that harmful state restrictions could not be deemed "unfair" would be inconsistent with this Congressional understanding. Since the passage of the Magnuson-Moss amendments, Congress' attention has been drawn repeatedly to Commission rulemakings that would reach state laws. Each time the issue has arisen during debates over amendments to the FTC Act, Congress has declined to limit the reach of our unfairness authority under section 18. In fact, in 1985 both the House and Senate expressly stated their understanding that the Commission's unfairness authority extends to prohibiting state restraints through rules such as the proposed Eveglasses II rule.[121] Against this legislative background, we believe that the Commission's unfairness authority is broad enough to encompass state laws.

C. Preemption

Although the language of the FTC Act does not expressly address the preemptive effect of Commission rules, it is clear that Section 18 trade regulation rules preempt inconsistent state law. Under the Supremacy Clause of the U.S. Constitution (Art. VI, section 2), federal law supersedes inconsistent state law. Validly enacted regulations of federal agencies have the same preemptive effect on inconsistent state

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[107] Realizing that it would be impossible to define with specificity all unfair practices, Congress considered and chose not to enact a statutory definition of the term "unfair method of competition." See S. Rep. No. 596, 63d Cong. 2d Sess. 13 (1914) and H.R. Conf. Rep. No. 1142, 63d Cong., 2d Sess. 19 (1940), *cited in American Financial Services* v. *FTC*, 767 F.2d 957 (1985).

[108] See Averitt, *The Meaning of "Unfair Acts or Practices" in section 5 of the Federal Trade Commission Act*, 70 Geo L.J. 225, 230–231, 235.

[109] 52 Stat. 111 (1938) (15 U.S.C. 45(a)(1)).

[110] Id.

[111] See, e.g., *Atlantic Refining Co. v. FTC*, 381 U.S. 357, 367 (1965); *FTC v. R.F. Keppel & Bros.*, 291 U.S.. 304, 310 (1934); *FTC v. Raladom Co.*, 283 U.S. 643, 648 (1931).

[112] See Unfairness Statement, supra note 28.

[113] *American Financial Services v. FTC*, 767 F.2d 957 (D.C. Cir. 1985). The court found that the Commission had not exceeded its authority in promulgating the rule, given that the Commission's articulated rationale comported fully with the criteria set out in the Commission's Statement. Id. at 982.

[114] Id. at 972. The court noted further that Congress had reviewed the Statement and "ha[d] not seen fit to enact any more particularized definition of unfairness to limit the Commission's discretion." Id. at 982.

[115] Unfairness Statement, supra note 28 at 5–6.

[116] See Final Staff Report, L–1, at 306–26.

[117] Unfairness Statement, supra note 28, at 7–8. *See also American Fianncial Services, Inc. v. FTC*, 767 F.2d 957, 98, (DC Cir. 1985).

[118] Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, 88 Stat. 2183 (1975) (15 U.S.C. 57(a)). The amendments extended the FTC's unfairness jurisdiction by adding the "affecting" commerce language to section 5 of the FTCA and by granting rulemaking power through section 18.

Some commenters argued that nothing in the Wheeler-Lea amendments authorized the Commission to find state laws to be unfair, and nothing in the Magnuson-Moss Act broadened the preexisting definition of unfairness. *See* Post-record comment of AOA, M–176, at 25–27 and Post-record comment of COA, M–178, at 22–29. We read the legislative history of Wheeler-Lea as confirmation of the principle that the unfairness standard must be a broad one. That interpretation is then brought to the legislative history of Magnuson-Moss where Congress did express its understanding that Section 18 rules would preempt state laws.

[119] See Final Staff Report, L–1, at 330–37.

[120] 117 Cong. Rec. 39840 (1971). See also discussion in Final Staff Report, L–1, at 339–40.

[121] 126 Cong. Rec. 2069, 2076–77 (1980). H.R. Rep. No. 99–162, 99th Cong., 1st Sess., 9–10 (1985) and S. Rep. No. 99–81, 1st Sess., 4–5 (1985). The bills accompanying these reports went to conference committee, but were never voted out. Earlier, in 1980, the Senate expressly rejected an amendment sponsored by Senators McClure and Melcher designed to stop the Commission from challenging the kind of state laws at issue in the Eyeglasses Rule and in the Eyeglasses II proceeding. 126 Cong. Rec. 2066 (1980). In defeating the McClure-Melcher amendment, opponents argued that state regulation of professionals was an entirely appropriate subject of FTC trade regulation rulemaking. 126 Cong. Rec. 2069 (1980) (statement of Sen. Metzenbaum); 126 Cong. Rec. 2076–77 (1980) (statement of Sen. Javits); 126 Cong. Rec. 2077 (1980) (statement of Sen. Inouye).

laws as federal statutes, even in the absence of any explicit Congressional statement of intent to preempt.[122] Where there is irreconcilable conflict between federal and state regulation and no express langauge about preemption.[123] Here that presumption is statute or in the legislative history, the customary Presumption is in favor of preeption.[123] Here that presumption is bolstered by the legislative history of the Magnuson-Moss Act and by subsequent court interpretations of Commission rulemaking power.

Those commenters who have insisted that the Commission cannot preempt state laws absent a clear indication of Congressional intent have misunderstood the nature of the rulemaking authority delegated to the Commission by Congress in the Magnuson-Moss Act.[124] A showing of express Congressional intention to preempt is necessary only where Congress directs an agency to "occupy a field" of regulation.[125] In enacting the FTC Act and Title II of the Magnuson-Moss Act Congress did not intend that the Commission "occupy the field" of Consumer protection[126] or antitrust regulation. In fact, in proposed legislation preceding passage of the Magnuson-Moss amendments, Congress sought to clarify the preemptive effect of Commission rules promulgated under Magnuson Moss by stating that the FTC Act would not occupy the field and that only inconsistent state laws would be preempted.[127] Throughout the period when rulemaking legislation was being considered, the record shows that Congress was aware of the preemption issue, invariably assumed that Commission rules would preempt inconsistent state law, and took no action to limit that preemptive effect.[128]

Courts that have considered and ruled on the issue have also recognized that FTC rules preempt inconsistent state laws, relying both on general Supremacy Clause principles and on Congressional intent in enacting the Magnuson-Moss Act.[129]

D. State Action

The state action doctrine of *Parker v. Brown* [130] does not limit the Commission's power under section 18 rules.[131] In *Parker*, the Supreme Court refused to construe the Sherman Act as applying to the anticompetitive conduct of a state acting through its legislature.[132] The doctrine has never been applied to the Commission's unfairness jurisdiction generally nor to our rulemaking authority in particular. Moreover, in enacting the Magnuson-Moss amendments, Congress considered the preemption issue and concluded that Commission rules should have broad preemptive effect. To apply the *Parker* doctrine to section 18 rulemaking would frustrate Congressional intent.[133]

Important differences between the Sherman and FTC Acts demonstrate that the policy reasons that led the Court to limit the reach of the Sherman Act do not apply to our rulemaking authority under section 18 of the FTC Act. In construing the Sherman Act, the Court recognized that, if the Act were to be applied to certain state actions, widespread and indiscriminate disruption of long-standing state economic legislation would occur. Well-established state economic regulation could be dismantled at the behest of private litigants with no consideration given to important state interests. Implicit in the Court's holding was the realization that if the Sherman Act were to apply to state action, private parties and state officials would be subject retroactively to treble damages and criminal sanctions for obeying otherwise valid state laws.[134] Given Congressional silence on the effect of the Sherman Act on state law, the *Parker* court concluded that Congress could not have intended such sweeping and possibly chaotic results.

Application of section 18 rulemaking to state legislation would not produce such dire consequences. First, challenges to state laws under section 18 can be initiated only by the FTC, a

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[122] See, e.g., Fidelity Federal Savings and Loan Ass'n v. De La Questa, 458 U.S. 141, 153–54 (1982). See also discussion in Final Staff Report, L–1, at 327–28.

[123] See, e.g., *Paul v. United States*, 371 U.S. 245 (1963); *Free v. Bland*, 369 U.S. 663 (1962).

[124] For example, both the AOA and the COA claimed that neither the language nor the legislative history of Magnuson-Moss show a clear manifestation of Congressional intent to grant FTC rules preemptive power. See Post-record comment of AOA, M–176, at 10–25 and Post-record comment of COA, M–178, at 22–28. They go on to note that Title I of Magnuson-Moss (i.e., warranty provisions) contains an express grant of preemptive power while Title II (i.e., section 18 rulemaking) contains no such express grant. However, in Title I Congress intended to occupy a portion of the field of warranty regulation and therefore needed to express the preemptive effect. Title II envisions only conflict preemption. The case law cited by these commenters unequivocally establishes that conflict preemption flows automatically from the Supremacy Clause, regardless of any express Congressional intent to preempt. See, e.g., *Fidelity Federal Savings and Loan Ass'n v. De La Questa*, 458 U.S. 141, 153–54 (1982); *Michigan Canners and Freezers Ass'n v. Agriculture Marketing and Bargaining Board*, 467 U.S. 461, 469–70 (1984; *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142–43 (1963).

[125] In those instances any state regulation on the same subject as the federal regulation is preempted even if the state regulation does not conflict with the federal requirements. See, e.g., *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947). In contrast, this rule displaces only four specified types of state restraints on the commercial practice of optometry. States continue to have broad authority to regulate the practice of optometry in order to safeguard the health of consumers. *See* discussion infra, section IV.

[126] The House Committee Report accompanying Magnuson-Moss noted that the FTC "should not intrude where cases of consumer fraud of a local nature are being effectively dealt with by State or local government." H.R. Rep. No. 93–1107, 93d Cong., 2d Sess. 45 (1974).

[127] S. 3201, 91st Cong., 2d Sess. 106 (1970). See S. Rep. No. 91–1124, 91st Cong., 2d Sess. 23 (1970).

[128] The Magnuson-Moss amendments were passed during the 93d Congress. However, similar measures had been introduced in the two previous Congresses. Language regarding preemption appeared in some, but not all, of the proposed bills and accompanying reports. As a consequence, arguments regarding Congress' ultimate purpose have been raised by a number of commenters. *See* Brief of the American Optometric Association, *AOA v. FTC*, H–81, App. A at 25–26 (Attachment to AOA comment). Our consideration of all of the evidence leads to the conclusion that Congress understood the traditional preemptive effect of federal rules and the presence or absence of statements in the various bills and reports reflects only Congressional efforts to clarify the scope of the existing preemptive authority. See Final Staff Report, L–1, at 330–37.

[129] In upholding the Credit Practices Rule, the Court of Appeals in *American Financial Services v. FTC* concluded that Congress intended FTC rules to have "that preemptive effect which flows naturally from a repugnancy between the Commission's valid enactments and state laws." 767 F. 2d 957, 989–90. The Court in *Katharine Gibbs School v. FTC*, 612 F.2d 658 (2d Cir. 1979), relied on similar reasoning on treating the preemption issue as settled. Although the Court remaded the rule in that case because the Commission had not defined with specificity the unfair acts and practices targeted by the rule, the court indicated that "questions of preemption could be answered with relatively little difficulty," if the Commission identified clearly the acts and practices encompassed by a rule. 612 F. 2d at 66. In the instant rulemaking, we have striven to define the unfair acts or practices with as much specificity as possible.

[130] 317 U.S. 341 (1942).

[131] Both the AOA and COA have contended that the state action doctrine applies to the federal antitrust laws generally, and therefore must apply to the FTCA. See Post-record comment of the AOA, M–176, at 29 and Post-record comment of the COA, M–178, at 29–30.

[132] 317 U.S. 341 (1942).

[133] The Commission has recognized that the *Parker* doctrine applies to adjudications brought under its unfair methods of competition authority, but only to the extent that the unfair methods of competition challenged consist of traditional Sherman Act violations. See *Massachusetts Furniture & Piano Movers Ass'n v. FTC*, 773 F.2d 391 (1st Cir. 1985); *Indiana Federation of Dentists*, 101 F.T.C. 57, 180 n. 24 (1983). In 1987, both the House and Senate passed versions of FTC authorizing legislation that would codify the Commission's application of the state action doctrine to its unfair methods of competition jurisdiction. In drafting this legislation, however, it is clear that Congress intended that the Commission's authority over unfair acts or practices not be limited by the state action doctrine. H.R. Rep. 271, 100th Cong. 1st Sess., 20 (1987).

[134] *See* Verkuil, *Preemption of State Law by the Federal Trade Commission*, 1976 Duke L.J. 225, 231; Note, *The State Action Exemption and Antitrust Enforcement Under the Federal Trade Commission Act*, 89 Harv. Law Rev. 715, 734–736 (1976).

federal agency with a mandate to protect the public interest and subject to Congressional oversight. In contrast, private parties seeking to protect private rights or enrich private pockets may use the Sherman Act to challenge state laws. Second, FTC rules apply prospectively, eliminating the danger of imposing retrospective penalties, such as those available under the Sherman Act,[135] against state officials or against private parties who have acted in good faith reliance on otherwise valid state laws.[136] Third, rulemaking is a more appropriate vehicle for examining whether federal or state interests are served by regulatory schemes than adjudicative actions under the Sherman Act. Unlike a private action brought under the Sherman Act, rulemaking allows for participation by all interested parties (including state officials) and for development of a record that reflects a broader perspective than could be achieved in private litigation. Because it more closely resembles the legislative than the adjudicative model, rulemaking is more conducive to the formation of public consensus and compromise. Finally, the application of the unfairness criteria in a section 18 rulemaking requires the Commission to consider the prevalence of the acts or practices, the nature of the injury, and any countervailing benefits. Thus, a section 18 rulemaking permits a review of state law that is both more flexible and potentially more protective of important state interests[137] than is an action under the Sherman Act, where the focus is exclusively on competition issues. Thus, any disruption of long-standing state economic legislation will not occur unless careful review of the evidence shows that minimal or no benefits flow from that legislation.[138]

Moreover, to the extent that *Parker* is a doctrine based on statutory construction, the clear differences in the legislative histories of the Sherman and Magnuson-Moss Acts support our view that Congress did not intend that *Parker* apply to section 18 rulemaking. While the legislative history of the Sherman Act is devoid of indications that Congress gave any consideration to the effect the Sherman Act would have on state law,[139] the legislative history of Magnuson-Moss is replete with evidence that Congress considered the relationship between the Commission's section 18 authority and state law.[140]

E. State as a "Person"

In order to declare state laws to be unfair acts or practices, we must be able to conclude that a state or its officials are "persons" within the meaning of the Federal Trade Commission Act.

While no federal court has determined this issue within the context of the FTC Act,[141] the Supreme Court has found state entities to be persons for the purpose of the Robinson-Patman Act[142] and the Sherman and Clayton Acts.[143] The Supreme Court has also found states to be persons under selected provisions of the IRS Code.[144]

In determining whether states meet the statutory definition of "person," the Supreme Court has generally looked to the legislative environment of the statute, including such factors as the subject matter, content, legislative history, and executive interpretation of the statute.[145] In addition, the Court has also considered whether exclusion of states from the statutory class of persons would frustrate the purpose of the statute.[146]

We have weighed these factors and believe that to exclude states from the reach of the Commission's unfairness authority would defeat the purpose of the FTC Act. The legislative history of the FTC Act indicates that Congress intended an expansive meaning to be given to the word "person."[147] Furthermore, the finding that states are persons within the meaning of section 5 for the purposes of this rulemaking is consistent with recent Commission decisions[148] and our reading of the entire FTC Act and its amendments, including the broad scope of the Commission's unfairness authority, as discussed supra at section III.B.[149]

IV. Federalism Concerns

As discussed above in section III., we are persuaded that the Commission has the legal authority to prohibit the state restraints at issue in this proceeding. Judicious exercise of that power, however, prompts us to consider whether we should act in this instance. We are keenly aware that this proceeding raises important questions about the proper allocation of power between the states and the federal government. However, after careful consideration, we are convinced that this rule is a proper exercise of federal power and is consonant with the principles of federalism.

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[135] The retrospective penalties provided for under the Sherman Act are treble damages and criminal sanctions. Courts have considered the nature of the remedy and whether the suit is brought by a private litigant or by the federal government to be relevant factors in determining whether Congress intended particular statutory provisions to apply to the states. See *Employees of the Department v. Department of Public Health and Welfare*, 411 U.S. 279 (1973). *Cf. Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389 (1977); *New Mexico v. American Petrofina, Inc.*, 501 F.2d 363, 367 (9th Cir. 1974).

In *Employees*, the Court was construing the Fair Labor Standards Act, which clearly covered both private parties and state governments. The only question in that case was whether the various redress provisions of the statute were intended by Congress to apply to state governments. The Court concluded that Congress did not intend to allow private parties to seek penalties from state governments although Congress did intend to allow the federal government to sue state governments for violations of this act. In reaching this conclusion the court was influenced by the fact that the penalty provisions "may saddle the states with 'enormous fiscal burdens,' and that 'Congress, acting responsibly, would not be presumed to take such action silently.' " *Employees of the Department v. Department of Public Health and Welfare*, 411 U.S. 279, 304 (Brennan, J., dissenting, quoting majority opinion at 284, 285).

[136] The imposition of penalties under the FTC Act is guided by FTC discretion, which is informed by the public interest. In § 456.4(b) of this rule, the Commission has stated that it will not seek the imposition of civil penalties against states, state agencies or state officials for violation of this rule.

[137] Letter from Federal Trade Commission to Senator Robert Packwood, Chairman, Committee on Commerce, Science and Transportation, United States Senate, March 5, 1982.

[138] *See* discussion *infra* at section IV.

[139] In a subsequent case, the Court stated that the legislative history actually contains some statements expressing a Congressional intention not to invade the legislative authority of the states. *Southern Motor Carriers Rate Conference v. United States*, 471 U.S. 48, 56 n. 19 (1985).

[140] *See* discussion of unfairness *supra* at Section III. B. There is also evidence to suggest that, at the time it amended the FTC Act in 1975, Congress was aware that the Commission might use its rulemaking power to challenge state-imposed restrictions on drug price advertising. *See* 120 Cong. Rec. 36150–52 (1974) (statement of Commissioner Thompson).

[141] But see, *California ex rel. Christensen v. FTC*, 1974–2 Trade Cas. (CCH) ¶75,328 (N.D. Cal. 1974), vacated and remanded, 549 F.2d 1321 (9th Cir.), cert. denied sub nom. *California Milk Producers Advisory Board v. FTC*, 434 U.S. 878 (1977).

[142] *Jefferson Co. Pharm. Ass'n v. Abbott Labs*, 460 U.S. 150, 155–56 (9183).

[143] *Lafayette v. Louisiana Power & Light Co.*, 435 U.S. 389, 394–97 (1978).

[144] See, e.g., *Sims v. United States*, 359 U.S. 108, 112 (1958); *Ohio v. Helvering*, 292 U.S. 360 (1934).

[145] Sims, 359 U.S. at 112 and *United States v. Cooper Corp.*, 312 U.S. 600, 605 (1941).

[146] See, e.g., *Plumbers' Local 298 v. County of Door*, 359 U.S. 354 (1959); *Union Pacific R.R. Co. v. United States*, 313 U.S. 450 (1941); *United States v. California*, 297 U.S. 175 (1936).

[147] See 51 Cong. Rec. 14,928 (1914); H.R. Rep. No. 553, 63d Cong. 2d Sess. (1914); H.R. Rep. No. 1142, 63d Cong. 2d Sess. (1914). See also Final Staff Report, L–1, at 363–64.

[148] See *Massachusetts Board of Registration in Optometry*, Docket No. 9195 (Final Order, June 13, 1988) and *Indiana Federation of Dentists*, 93 F.T.C. 321 n. 1 (1979) (interlocutory order).

[149] The Commission took the same position when it promulgated the Eyeglasses Rule. Statement of Basis and Purpose for the Trade Regulation Rule on Advertising of Ophthalmic Goods and Services, 43 FR 23992, 24004 (1978). On appeal of that rule, the court reserved judgment on the issue of whether the Commission could exercise jurisdiction over the states. *American Optometric Ass'n v. FTC*, 626 F.2d 896 (D.C. Cir. 1980).

Because we are dealing with state law, we have proceeded with extreme caution at each step of this rulemaking. Procedural safeguards are built into section 18 rulemakings to ensure that all interested parties have ample notice so that they have an opportunity both to present their views and evidence and to challenge the evidence and views submitted by other parties.[150] In deference to the significant state interests at stake, we solicited the views of state officials as well as industry members and consumers. We gave every consideration to claims that quality of care concerns justify these restrictions and would have deferred to any credible showing of countervailing benefits. In fact, when state laws are the subject of a section 18 rulemaking, the Commission has required that there be an even more rigorous showing of consumer injury and absence of countervailing benefits than is required under the Commission's unfairness standard.[151]

Nonetheless, as discussed above in section II.C., the record contains no persuasive evidence that commercial practice restrictions have any positive effect on the quality of care consumers receive or that they promote any other legitimate state interest. On the other hand, the record shows that state-imposed restraints on the commercial practice of optometry seriously hinder the provision of eye care to consumers. These restraints impose substantial costs on consumers. The primary effect of this regulation is to protect one category of providers, primarily solo practitioners, from competition from high-volume chain firms—at an annual cost to consumers of millions of dollars. This stifling of competition not only leads to higher prices and less eye care for consumers today, but delays the development of more innovative and cost-effective ways of providing services tomorrow.[152]

While we are convinced of the injury that these restrictions cause, we are also mindful of the states' traditional role in protecting the health and welfare of their citizens. Therefore, we have drafted this rule narrowly so as not to intrude gratuitously on the legitimate exercise of the police powers of the state.[153] The extent of our "intrusion" is carefully limited to those regulations that have been shown to be unfair, and should not interfere with the states' ability to protect their citizens from deceptive or abusive practices by optometrists or to ensure that high-quality optometric care is provided.

What the rule does challenge is state regulation that, in effect, insulates local optometrists from competition from large, price-competitive chain firms, most of which operate interstate.[154] Thus, this rule intrudes on no traditional state interest. Rather, it represents an appropriate exercise of the Commission's responsibility, grounded in the Commerce Clause, to protect markets from unfair or deceptive acts or practices.

By empowering the federal government to regulate commerce, the framers clearly sought to limit the extent to which states could restrict the development of interstate markets. Such limits were originally seen as necessary to protect the nascent national economy from the protectionist actions of the states, which the framers feared would lead to a destructive cycle of discrimination against out-of-state goods and the retaliation that would inevitably result.[155] That some policy of limiting state authority over interstate markets, underlying the Commerce Clause, favors Commission action here to prevent states from denying interstate ophthalmic providers access to local markets when the evidence demonstrates that the states' asserted basis for such actions—to protect citizens from poor-quality ophthalmic care—has no substantial basis in fact.[156]

In providing the Commission with Section 18 rulemaking authority, Congress has made a limited delegation to the FTC of its legislative authority to protect consumers from acts or practices that unreasonably interfere with the efficient functioning of interstate markets. We find that the existing restrictions on commercial practice are designed to and do impede the efficient flow of interstate commerce, and that they impose significant costs on consumers without providing any countervailing benefits. Thus, they constitute the kind of unfair acts or practices that Congress authorized the FTC to challenge in section 18 rulemaking.

We also believe that promulgation of this rule is consistent with a recent Executive Order on federalism.[157] That Order sets out certain policymaking criteria to guide executive agencies in the formulation of federal policy. In particular, the Order directs executive departments and agencies to act in strict adherence to constitutional principles and limit the policymaking discretion of states only where there is clear and certain constitutional authority and only where there is a problem not merely common to the states, but national in scope. In addition, the Order directs that any regulatory preemption of state law be limited to the minimum level necessary to achieve the objectives of the statute.

While the FTC is not bound by the requirements of this Order, we believe

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[150] The Magnuson-Moss amendments impose additional safeguards beyond those mandated by the Administrative Procedure Act. These include additional hearing requirements and expanded scope of review by the courts. 15 U.S.C. 57a. See also Verkuil, *Preemption of State Law by the Federal Trade Commission*, 1976 Duke L.J. at 242–43; Note, *The State Action Exemption and Antitrust Enforcement under the Federal Trade Commission Act*, 89 Harv. L. Rev. 715, 745–50 (1976).

[151] Letter from Federal Trade Commission to Senator Robert Packwood, Chairman, Committee on Commerce, Science and Transportation, United States Senate, March 5, 1982. Our decision to forego remedies normally available for violations of the FTC Act is a further indication of our recognition that the actions of states and their officials, as opposed to actions by private citizens, merit special consideration in an unfairness proceeding. *See* discussion of Commission's enforcement policy *infra* in section V.

[152] For over thirty years scholars have written at length of the various ways in which excessive state economic regulation—such as these restrictions on the commercial practice of optometry—distorts the operation of markets and harm consumers. See, e.g., P. Verkuil, *State Action, Due Process and Antitrust: Reflections on Parker v. Brown*, 75 Col. Law Rev. 328 (1975); G. Stigler, *The Theory of Economic Regulation*, 2 Bell J. Econ. & Mgmt. Sc. 3 (1971); W. Gellhorn, *Individual Freedom and Governmental Restraints* (1956).

[153] In response to the cautionary message of the Court of Appeals in the Eyeglasses Rule, we have drafted this rule to focus narrowly on four specific areas of commercial practice. In remanding the advertising portions of the rule, the Court stated that the Commission had preempted the whole field of ophthalmic advertising, and so had "at least approached the outer boundaries of its authority." 628 F.2d 896, 910. The Court went on to state that answers to questions regarding preemption and state action "may depend . . . on the extent to which a federal regulation gratuitously intrudes on the exercise of police powers of the states." Id.

[154] While on their face these restrictions do not discriminate against out-of-state providers, they, in fact, have a disproportionately harmful effect on high-volume practices that operate interstate.

[155] Under the Articles of Confederation, some states engaged in protectionist activities that threatened to affect the development of a vital interstate economy. For example, New York imposed port fees and tonnage duties on vessels from Connecticut and New Jersey, increasing the cost of farm products coming from those two states. In retaliation, New Jersey taxed the property for the lighthouse at Sandy Hook that New York had built, while Connecticut merchants suspended commercial dealings with New York for one year and imposed fines on those who disregarded the boycott. A. Giesecke, *American Commercial Legislation Before 1789*, 134–135 (1910). See also C. P. Nettels, *The Emergence of a National Economy, 1775–1815*, 72–73 (1977).

[156] We take no position on whether the commercial practice restraints that are the subject of this rulemaking could be challenged successfully by private parties using a Commerce Clause theory and the evidence on this record.

[157] Exec. Order No. 12,612, 52 FR 41685 (1987).

this rule conforms to the policymaking criteria outlined in the Order. We have proceeded under the clear and enumerated power of Congress to protect interstate commerce. The legislative history of the Magnuson-Moss amendments and subsequent Congressional action provide clear authority for this rule. We have identified a serious problem amenable to solution only at the national level; we have carefully examined the proffered claims of state interest; and we have fashioned a narrowly drawn deregulatory response that does not intrude on the legitimate interests states have in protecting the health and safety of their citizens.

V. Section-by-Section Analysis

The following section-by-section analysis explains the intended scope and meaning of each of the rule provisions adopted by the Commission.

Section 456.1: Definitions

This section defines certain terms used in the rule. Many of these terms are contained in the Eyeglasses Rule and relate to the prescription release requirement. The rule makes some modifications to terms used in the Eyeglasses Rule and includes some new definitions.

Paragraph (a): The term "patient" has been substituted for the term "buyer" to conform more closely to industry usage. The term covers anyone who has undergone an eye examination.

Paragraphs (b), (c), and (d) remain unchanged from the original rule definitions.

Paragraphs (e) and (f) replace § 456.1(h) of the Eyeglasses Rule. The specific terms "ophthalmologist" and "optometrist" in paragraphs (e) and (f) have been substituted for the general word "refractionist" used in § 456.1(h) of the Eyeglasses Rule to define those categories of providers—Doctors of Medicine, Osteopathy and Optometry—who are qualified under state law to perform eye examinations. This change was made for two reasons. First, the use of the term "refractionist" in the Eyeglasses Rule has caused confusion because it is not generally used by consumers or by industry members. Second, the provisions of the Eyeglasses II Rule relating to commercial practice apply to optometrists, not ophthalmologists. The term "refractionist" has been deleted so that this distinction is clear.

Paragraph (g): The definition of the term "person" has been changed. This term was originally used in § 456.6 of the Eyeglasses Rule. That rule provision is no longer in effect, so the original definition of the term is no longer relevant. The term "person" is now used only in the rule provisions concerning commercial practice. The definition has been changed to make it clear that the term covers any individual, partnership, corporation or other entity, whether or not the FTC has jurisdiction over the "person."

Paragraph (h): The term "prescription" is defined as those specifications necessary to obtain lenses for eyeglasses. Thus, under the rule, the prescription that is released to the patient need only contain the data on the refractive status of the patient's eyes and any information, such as the date or signature of the examining optometrist or ophthalmologist, that state law requires in a legally fillable eyeglass prescription. The definition deletes all references to contact lenses. This change is intended to end the confusion generated by the definition in the Eyeglasses Rule concerning the obligation of optometrists and ophthalmologists to place the phrase "OK for contact lenses" (or similar words) on eyeglass prescriptions. No such obligation exists under the rule. This change will also clarify the fact that the prescription release requirement does not affect state laws regulating who is legally permitted to fit contact lenses. This change does not affect the requirement that optometrists and ophthalmologists offer prescriptions for lenses for eyeglasses to all patients whose eyes they examine, including those patients who wear or intend to purchase contact lenses.

Paragraph (i): The definition of "optometric services" is new. It is intended to cover the full range of services which may be provided by an optometrist under state law. The precise meaning of the term may vary slightly from state to state since states define the practice of optometry differently. The term only includes services provided by an optometrist, not by other professionals such as ophthalmologists who may also be licensed under state law to provide such services.

The new term is needed because the terms in the rule as originally proposed did not cover the full range of services which may be provided by optometrists. The term "ophthalmic services," as defined in § 456.1(d), covers only the measuring and fitting of eyeglasses or contact lenses subsequent to the eye exam. The term "eye examination," as defined in § 456.1(b), covers tests and procedures to determine the refractive status of the eyes. Optometrists are licensed to perform other services, however. For example, optometrists may prescribe eye exercises to deal with eye muscle problems or, in many states, prescribe topically applied prescription drugs to treat certain forms of eye disease. All such activities are included under the term "optometric services."

Section 456.2: Separation of Examination and Dispensing

This section requires that optometrists and ophthalmologists give prescriptions for eyeglass lenses to their patients immediately after completing an eye examination. Except for minor changes in terminology, this section is identical to the prescription release requirement contained in the Eyeglasses Rule (originally § 456.7).

Paragraph (d) addresses the use of waivers or disclaimers of liability. As the Commission makes clear in its declaration of intent (§ 456.5(c)), the rule does not impose liability on an ophthalmologist or optometrist for the ophthalmic goods and services dispensed by another individual pursuant to the ophthalmologist's or optometrist's prescription. By its terms, the rule proscribes only "waivers or disclaimers" of the physician's or optometrist's own responsibility. The Commission has interpreted this portion of the rule to permit nondeceptive affirmative statements concerning responsibility. For example, a written statement that "the person who dispenses your eyeglasses is responsible for their accuracy" would not violate § 456.2(d). However, such an affirmative statement cannot be coupled with a waiver or disclaimer of the optometrist's or ophthalmologists's own liability.[158]

Section 456.3: Federal or State Employees

This section (originally § 456.8 of Eyeglasses Rule) deletes references to the remanded portions of the Eyeglasses Rule and clarifies the intended effect of this section. This section exempts practitioners who work for any federal, state, or local government agency from the rule's prescription release requirements. If practitioners work only part-time for the government, the exemption only applies when they are engaged in their governmental duties.

Section 456.4: State Bans on Commercial Practice [159]

Paragraph (a)(1): Lay Association. The purpose of this section is to

[158] 43 FR 46296–46297 (1978).

[159] State bans may arise from a variety of sources: statutes, regulations, attorney general opinions, court opinions, and enforcement policy decisions by state boards and other state agencies. Regardless of the method used or the state entity involved, the rule prohibits such bans.

invalidate state prohibitions on optometrists' entering into certain designated business associations with nonoptometrists that make it possible to provide optometric services and ophthalmic goods and services to consumers in more efficient ways.

As originally proposed, § 456.4(a)(1) proscribed state prohibitions on "employer-employee or other business relationships" between optometrists and nonoptometrists. However, we realized that this language would leave some uncertainty in the minds of lawmakers and practitioners as to the scope of the rule.[160] We have narrowed the language of § 456.4(a)(1) to make it an unfair act or practice for states to prohibit those specific types of associations that the record demonstrates are critical to the development of commercial practice: (1) The employment of optometrists by lay persons or corporations to provide optometric services; (2) partnership agreements, joint-ownership or equity-participation agreements, profit-sharing agreements, or franchise agreements [161] between optometrists and nonoptometrists (including those that involve the sharing of revenues between optometrists and nonoptometrists) for the purpose of providing optometric services or ophthalmic goods or services; or (3) the leasing of office space by optometrists from nonoptometrists, including the payment of rentals on such leases based on a percentage of the optometrist's revenues.

The record also demonstrates that lay control over the business aspects of an optometric practice is an integral element of commercial practice. Subsection (v) invalidates those state regulations that prevent lay persons or corporations from controlling those business aspects of a practice that the record demonstrates have no effect on quality of care—e.g., setting of fees, salaries, or minimum office hours; location of the practice; choice of suppliers of material, equipment, services, and laboratory work; establishing minimum quantities of materials in stock and minimum equipment;[162] advertising, promotion, and marketing practices; accounting and financial practices; office design, decor, and maintenance; and other activities that involve business judgments to a similar degree.[163] As discussed more completely herein, this provision of the rule does not prevent states from passing regulations concerning these business aspects of optometry. It simply prevents the states from mandating that optometrists alone, and not lay persons or corporations, must make these decisions.

Finally, the language of this provision makes clear that the only affiliations covered by § 456.4(a)(1) are affiliations for the purpose of "providing optometric services" or "forming entities whose business, in whole or part, is providing optometric services or ophthalmic goods and services to the public." The inclusion of this language makes clear that affiliations for anything other than this stated purpose are not covered by the rule.[164]

The rule does not interfere with a state's ability to adopt or enforce any law or regulation that addresses specific harmful practices arising from lay association. For example, the rule does not interfere with a state's ability to prohibit improper lay control of the practice of optometry or the professional judgment of an optometrist, where the terms "practice of optometry" or "professional judgment" do not encompass those business aspects of a practice described in subsection (v).

The rule does not affect the ability of the states to prohibit the use of certain compensation schemes. For example, states could, if they were so inclined, prohibit employers of optometrists from setting quotas for the number of examinations that optometrists must perform. States could also choose to ban the payment of commission based on the number of examinations given or prescriptions written by optometrists. The evidence in this record does not establish that commission payments provide clear consumer benefits or that they result in no consumer injury.[165]

States may also establish minimum standards of competence or honesty and discipline those optometrists, commercial or not, who fail to meet those standards. In short, under the rule, states retain broad authority to regulate the commercial and traditional practice of optometry in order to protect the health and safety of their citizens and to prevent abuse of consumers.

Paragraph (a)(2): Branch Offices. The rule allows optometrists to own, operate, or practice in any number of offices. Corporations or other entities which offer optometric services through affiliations between optometrists and lay persons, as allowed by § 456.4(a)(1) of the rule, would also be permitted to own or operate any number of offices.

The rule also prohibits states from requiring optometrists to remain in personal attendance at each branch office for a specific percentage of the time the branch is open. Such a requirement effectively limits the number of branch offices that an optometrist may own and therefore is prohibited by the rule.

However, as § 456.5(a) makes clear, the states retain broad authority to regulate health and safety and to

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[160] For example, some commenters argued that the original language was broad enough to encompass regulations banning "capping and steering" and referral arrangements. While in some instances such regulations may be unconstitutional restraints on commercial speech, the rule language makes clear that the rule does not cover such prohibitions.

[161] Typically, under an optometric franchising arrangement, the optometrist pays the franchiser for a specified set of goods or services, which might include the use of the franchiser's trade name and trademarks, the benefits of its goodwill, proven method of doing business, volume discounts on equipment and inventory, financing available through the franchiser, and participation in the franchiser's advertising program. The franchiser retains control over many aspects of the franchisee's business organization, such as office design, items stocked, and minimum quality standards. J. Solish, Attorney, R.H. Teagle Corp., Tr. 1368–72; cf. P. Zeidman, Attorney, National Franchise Association, Tr. 591 (describing attributes of franchising agreements generally).

[162] Obviously, these minimum standards would have to accord with any state-imposed standards for optometric practice. Furthermore, under the rule, states could require that optometrists be permitted to have equipment and inventory above the minimum level established by the lay person or corporation.

[163] The record establishes that corporations which associate with optometrists—for example, by employing optometrists or entering into franchise agreements—where currently permitted, commonly control these aspects of the business. See, e.g., NAOO, H–78a, at 39–40 and Appendices J, K, L, and M. Other evidence on the record, see supra section II.C., demonstrates that associations between optometrists and lay persons have no adverse impact on the quality of care available in the market.

[164] For example, the rule was never intended to address commercial practices by ophthalmologists. The record evidence centers on commercial optometric practice; there is little evidence concerning commercial practice by opthalmologists. Under this provision, ophthalmologists also may enter into affiliations with optometrists for the purpose of providing optometric services or ophthalmic goods and services to the public.

The term "sellers" also appeared in the proposed language of § 456.4(a)(1). Sellers was defined to include opticians. As a result, the rule as originally proposed would have prohibited state restraints on lay persons employing (or otherwise affiliating with) "sellers." The record shows that the law of only one state prohibits such affiliations, and no evidence or comments were submitted about this restriction. Consequently we decline to extend the rule to such a restriction.

[165] In contrast to sa franchise or leasing arrangement, for example, where an optometrist pays a percentage of his gross revenue to the franchiser or lessor, commission payments entail a payment to an optometrist which varies depending upon the number of eyeglasses sold or revenue generated by the optometrist. The former creates no incentive for the optometrist to overprescribe while the latter arguably does.

prevent consumer abuses. For example, states could require that optometric services or ophthalmic goods or services provided at each office be supplied only by a person qualified to do so. As another example, states could regulate the services provided at each office by requiring minimum eye examination procedures, minimum office equipment, or a specific level of sanitation.

Paragraph (a)(3): Mercantile locations. This provision allows optometrists to locate their practices inside retail optical stores, department stores, or other mercantile establishments. Optometrists can also locate in shopping malls or adjacent to optical retailers. Under the rule corporations and other entities that offer optometric services by employing optometrists or otherwise affiliating with optometrists, pursuant to § 456.4(a)(1) of the rule, can also locate in mercantile locations.

Consequently, the rule also eliminates so-called "two-door" or "side-by-side" requirements, which are frequently used to prohibit optometrists from locating directly inside mercantile establishments. These requirements mandate separate offices for the optometrist and the optician, including, in some instances, separate doors and duplicate facilities and partitions between the two offices. Under the rule, states could not require separate offices, separate entrances, duplicate facilities, or partitions.

Finally, as § 456.5(a) makes clear, the rule is not intended to interfere with the state's ability to enforce general zoning laws or any law, rule, or regulation which prohibits the location of an optometric practice in an area which would create a public health or safety hazard.

Paragraph (a)(4): Trade Names.[166] The rule invalidates state prohibitions on optometrists' practicing under any nondeceptive trade name. Thus, for example, optometrists employed by a chain firm could practice under the name of the chain firm as long as the name was not deceptive. Optometrists working for other optometrists could practice under the name used by their employer. Optometric franchisees could practice under the franchise name. Solo practitioners could adopt any nondeceptive trade name. Corporations and other entities which offer optometric services through affiliations with optometrists, pursuant to § 456.4(a)(1) of the rule, could also practice under any nondeceptive trade name.

Some states, for example, require that any trade name include the name of one or more of the optometrists practicing under the trade name.[167] Such requirements would violate the rule since they prohibit use of a wide variety of nondeceptive trade names, including some that are well-established in other states. Other states require that all trade names used by optometrists include the word "optometric" or "optometrist."[168] Trade names which do not include these terms, such as "Smith Optical Center," are not in general, deceptive. Such a requirement would also be prohibited under the rule, since it would prohibit the use of all other nondeceptive trade names.[169]

The rule also allows optometrists to advertise under a trade name in a nondeceptive manner. For example, optometrists could display their trade names on signs and use the trade name in media advertising. Similarly, chain firms offering eye exams could advertise optometric services under the trade name.

The rule also prohibits states from mandating that any trade name advertisement disclose the names of all optometrists practicing at a given advertised location or practicing under the advertised trade name.

However, as § 456.5(a) (3) and (4) make clear, the rule does not infringe on the state's ability to enforce any law, rule, or regulation which requires that the identity of an optometrist be disclosed to a patient before, during, or after the time optometric services are provided or ophthalmic goods are dispensed or from enforcing any state law, rule, or regulation that is reasonably necessary to prevent the deceptive use of trade names in advertising. Also, the rule would not prevent states from imposing reasonable disclosure requirements on any trade name advertising.

Sections 456.4(b) and 456.5(b): Enforcement Policy

The Commission expects that the states will comply voluntarily with the rule. If, however, a state or local governmental agency or official attempts to enforce a state law or regulation that conflicts with the rule, § 456.5(b), while not creating a private right of action, recognizes that individuals can interpose the rule as a defense in any proceeding brought by the state. In such a situation, a person could correctly assert that the rule preempts the state law or regulation and therefore there is no basis on which any enforcement action could be brought. Because the Commission expects the states to comply voluntarily with the rule, it does not anticipate bringing any law enforcement actions against state or local governmental agencies or officials. Section 456.4(b) of the rule also provides that no state or local governmental agency or official is liable for civil penalties, consumer redress, or other monetary relief that would ordinarily be available under the FTC Act for violations of this rule.

Section 456.5: Declaration of Commission Intent

Paragraph (a): Section 456.5(a) is intended to make clear that the rule does not affect any state regulation as long as the state does not engage in the specific practices enumerated in § 456.4(a) (1)–(4). Thus, the rule does not interfere with a broad range of state regulation that safeguards the health and safety of eye care consumers, or prevents unfair or deceptive practices or anticompetitive conduct by eye care providers, including commercial practitioners. For example, many states specify that particular procedures must be performed each time an optometrist performs an eye examination or that every optometrist's office must have particular equipment. Many states require that optometrists refer cases of suspected pathology to ophthalmologists, or require that optometrists verify the accuracy of lenses prepared according to their prescriptions. All states prohibit fraud and deception in the practice of optometry and virtually all require that optometrists practice "competently."[170] The rule does not interfere with a state's ability to regulate optometry, including commercial practice, through such regulations.

We also acknowledge that a state or local government can enact regulation that may have an incidential impact on the ability of optometrists to engage in the specific practices covered by the rule, as long as the regulation does not distinguish between commercial and

[166] Section 456.1(j) of the rule as originally proposed defined the term "trade name ban." The rule incorporates the substance of this definition in this section, which bars states from prohibiting the use of trade names. Thus, a separate definition is unnecessary.

[167] See, e.g., La. Rev. Stat. Ann. section 1112 (West 1952); Mo. Admin. Code Tit. 4, CSR 210-2.060(4)(E) (1984); Or. Admin. R. section 852-300-010 (1984).

[168] See, e.g., Minn. R. 6500.0800, Subp. 3 (1987).

[169] In fact, use of the term "optometric" in the trade names of large chain firms could well be confusing to consumers since the term may imply that optometric services are available at all the chain's retail locations when, in fact, this may not be the case.

[170] See Final Staff Report, L-1, at 45-46.

noncommercial optometrists or optometric firms. Thus, the rule does not invalidate state labor laws, antitrust laws, zoning laws, or other state or local regulation that may have an incidential impact on the ability of optometrists to engage in the conduct protected by the rule.

Paragraph (b): See analysis of § 456.4(b) for a discussion of the Commission's views regarding the ways in which the Commission intends the rule to be enforced.

Paragraph (c): See analysis of waivers and disclaimers of liability in § 456.2(d).

VI. Alternatives Considered

During the course of this proceeding the Commission carefully considered alternative approaches to the promulgation of a rule. We also considered adopting a broader prohibition on commercial practice restraints—one that would reach indirect as well as direct bans—and considered various proposed modifications to the existing prescription release provisions. Each of these alternatives is discussed below.

A. Alternatives to Promulgation of a Rule

1. *Take no action; defer to the states.* The Commission could leave to the states the decision whether or not to eliminate these restrictions. The Commission could continue to make its staff studies and other evidence available to state legislatures and regulatory agencies, or could develop a model state law, in the hope that states would take corrective action in this area. However, the prospects for significant change are dim. The BE Study has been available since 1980, and staff has testified or submitted comments in support of deregulation of commercial practice in a significant number of states.[171] Nevertheless, the record indicates that such restrictions are still widespread.[172] Based on this record we have no reason to expect that more than a few states will voluntarily repeal commercial practice restrictions in the foreseeable future.

2. *Case-by-case approach.* A second alternative would be to issue complaints and proceed on a case-by-case basis against particular states or state regulatory boards.[173] Rulemaking appears to be the more appropriate vehicle for a number of reasons, especially since nearly all of the states would be affected. Rulemaking procedures permit all affected and interested parties, including all potentially affected states, to participate in a full and open discussion of the issues and to present evidence for and against the proposal. In a rulemaking proceeding, the Commission can assess the implications of the proposal on a nationwide basis more readily than in a case against one state. In addition, promulgation of a rule would provide more complete protection for consumers. Even if an order were issued against a particular state or state regulatory board, that order would not extend to other states with similar restrictions. Thus, significant numbers of consumers would be left without relief in other states. Case-by-case adjudication against a number of states would be more time-consuming and costly than rulemaking.

B. Alternative Rule Provisions

1. *Commercial Practice—Direct and Indirect Bans.* The rule as proposed at the start of this proceeding covered state restraints that directly or indirectly prohibited commercial practice.[174] Such a formulation would have given the Commission the greatest flexibility in reaching indirect attempts to prohibit commercial practice. At the same time, the Commission was mindful that such an approach arguably would invalidate many laws and regulations not specifically enumerated in the rule. We chose to promulgate a more limited rule that defines the invalidated restrictions very clearly in order to eliminate any uncertainty regarding which laws or regulations are affected by this rule. The rule sets out four types of state laws that act as direct restraints on the commercial practice of optometry: (1) Bans on lay association; (2) limitations on branch officies; (3) bans on mercantile locations; and (4) bans on trade names.

Additionally, we have clearly identified and incorporated into the rule four other types of restraints that interfere with activities essential to the functioning of commercial practice: (1) Bans on the sharing of profits (§ 456.4 (a)(1) (i)); (2) bans on lay control over the business aspects of a practice (§ 456.4 (a)(1) (v)); (3) requirements that specify that owners of branch offices remain in personal attendance at each branch for a specific percentage of the time that the branch is open (§ 456.4 (a)(2)); and (4) requirements that mandate the disclosure in advertising of the names of all optometrists practicing at a given advertised location or practicing under a trade name (§ 456.4 (a)(4)).

The rule is now much narrower. It proscribes only those specified types of state laws and regulations that the record demonstrates create serious barriers to the formation and operation of commercial optometric firms and thereby cause significant consumer injury.

2. *Prescription Release.* On June 2, 1978, the Commission promulgated the Eyeglasses Rule.[175] That rule, in pertinent part, requires optometrists and ophthalmologists to release to their patients copies of their eyeglass prescriptions immediately following eye examinations regardless of whether or not the patient requests the prescription.[176]

The Commission found that many consumers were being deterred from comparison shopping for eyeglasses because optometrists and ophthalmologists refused to release eyeglass prescriptions even when requested to do so, or charged an additional fee for release of the prescription.[177] The Commission promulgated an automatic release requirement based on a finding of "consumers' lack of awareness that the purchase of eyeglasses need not be a unitary process"—i.e., that purchasing eyeglasses can be separated from the process of obtaining an eye exam.[178] The automatic release provision was thus imposed as a remedial measure.

In this proceeding the Commission considered whether or not the prescription release requirement should be modified or extended. The major modification considered was amendment of the rule to require that prescriptions be provided only upon request of the patient. In addition, the Commission asked for comment on five

[171] Comments regarding restrictions on the commercial practice of optometry have been submitted to at least nine states, including California, Delaware, Kansas, Mississippi, New Jersey, North Dakota, Oregon, Texas, and Virginia.

[172] See Final Staff Report, L-1, at 33-46.

[173] Proceeding against private associations would not be effective since it would do nothing to remove the state-imposed restraints at issue in this proceeding.

[174] See 50 FR 598 (1985). This intention was specifically stated in proposed §§ 456.5 (b) and (c).

[175] 43 FR 23,992 (1978) (codified at 16 CFR 456).

[176] The rule also prohibits optometrists and ophthalmologists from charging additional fees for the prescriptions, from conditioning the availability of eye examinations on the purchase of ophthalmic goods, or from including waivers of liability on the prescription. These provisions were upheld by the U.S. Court of Appeals in 1980. *American Optometric Assoc. v. FTC*, 626 F.2d 896 (DC Cir. 1980).

[177] In addition, some practitioners refused to conduct an examination unless the patient agreed to purchase eyeglasses from the practitioner or included potentially intimidating disclaimers of liability on the prescription itself. 43 FR 23992, 23998 (June 2, 1978).

[178] See Final Staff Report, L-1, at 251-52.

other possible changes in the rule.[179] The Commission considered the record evidence on each of these proposals and chose not to adopt any of them for the reasons outlined below.

a. *Automatic Release.* The Commission decided to retain the remedial aspect of the prescription release requirement after consideration of two surveys[180] placed on the rulemaking record, as well as numerous comments and testimony offered by optometrists, opticians, professional associations, state boards, and consumer groups.

Our reading of the record reveals that there is significant non-compliance with the automatic release requirement[181] and that there continues to be a lack of consumer awareness about prescription rights. Given that the record does not contain sufficient evidence to conclude that the remedial aspects of the rule are no longer needed, we decline to modify or repeal the rule.[182]

b. *Contact Lens Prescription Release.* The NPR requested comment on whether significant numbers of consumers were refused copies of their contact lens prescriptions, whether consumers could reasonably avoid these refusals, and what are the costs and benefits of extending the prescription release rule to contact lenses.[183] While the record suggests that it is not uncommon for practitioners to refuse to give patients copies of their contact lens prescriptions,[184] and that the resulting costs to consumers could be significant,[185] we do not believe that the record contains sufficient reliable evidence to permit a conclusion that the practice is prevalent.

Moreover, even if the evidence on prevalence of refusal to release contact lens prescriptions and resulting injury to consumers were satisfactorily documented, we would have to consider if any countervailing benefits justified the refusal. Some commenters suggested that refusal to release is necessary to permit the fitter to verify the fit of the lens[186] on the eye because there is some danger that lenses may not conform to the eye as expected.[187] According to these commenters, it would be inappropriate to require them to release contact lens specifications to their patients, since patients could then obtain replacement lenses from dispensers that do not verify the fit.[188]

Because the record evidence is insufficient to evaluate this claim fully, the Commission cannot conclude that a refusal to release a contact lens prescription is an unfair act or practice.

c. *Other Prescription Release Matters.* The Commission received no substantial evidence showing that practitioners refuse to release duplicate copies of prescriptions to patients who lose or misplace their original copies, or that eyeglass dispensers refuse to return prescriptions to patients after filling the prescription.[189] Because we do not have sufficient evidence to show that either of these practices is prevalent, rulemaking in these areas would be inappropriate.

VII. Other Matters

A. Cost-Benefit Analysis

Before the Commission determines that an act or practice is legally unfair, we analyze the act or practice in terms of the scope and nature of the injury it causes and in light of any offsetting benefits it provides. In sections II. B. and C., we set out a detailed summary of the injury imposed by commercial practice restrictions and the absence of any countervailing benefits that might justify the restrictions. However, we also must consider the projected benefits and effects of the rule that we are promulgating.[190]

1. *Effect on Consumers.* The primary benefit to consumers from the removal of commercial practice restrictions is that they will be able to purchase vision care goods and services at lower prices without any compromise in quality of care. The record evidence indicates that (1) Prices are significantly lower in markets where commercial practice is not restricted; (2) commercial optometrists charge lower prices than noncommercial optometrists; (3) noncommercial optometrists who operate in markets where commercial practice is permitted charge less than their counterparts in markets where commercial practice is prohibited; and (4) overall quality of care is no lower in nonrestrictive than in restrictive markets. As restrictions on commercial practice are removed, competition among optometrists should increase. Lower prices should then result from this increased competition and from economies of scale achieved by larger optometric providers. Lower prices will also increase the availability of ophthalmic goods and services to consumers who before could afford such services infrequently, or in some instances, not at all.

Implementation of the rule will have no adverse effect on consumers. They will be able to obtain the same overall quality of care, but at lower prices. Finally consumers will benefit from their ability to choose, if they wish, the convenience of one-stop service (eye examinations plus eyeglass or contact lens dispensing) from optometrists or retail optical firms who employ optometrists.

2. *Effect on Industry Members.* The rule will directly affect all opthalmologists and optometrists who perform eye examinations and all optometrists, opticians, and others who desire to engage in commercial ophthalmic practice. In 1982, there were approximately 12,000 ophthalmologists, 22,000 optometrists, and 26,000 opticians in active practice in the United States. Most ophthalmologists and optometrists are self-employed. The majority of

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[179] (1) Should the rule require optometrists and ophthalmologists only to offer, rather than give, eyeglass prescriptions to their patients? (2) Should the requirement be repealed altogether? (3) Should the rule be extended to require the release of contact lens prescriptions to patients? (4) Should the rule be extended to require optometrists and ophthalmologists to release duplicate copies of prescriptions to patients who lose or misplace their original copies? and (5) Should the rule require dispensers of eyeglasses to return the eyeglass prescription to patients after filling the prescription? 50 FR 602–03 (1985).

[180] The Market Facts Study, supra note 18, developed by staff in conjunction with the Market Facts Public Sector Research Group, was designed to measure eye doctors' compliance with the prescription release requirement and consumer knowledge and experience with prescriptions. The American Association of Retired Persons also submitted a survey conducted in 1985. That survey polled older consumers to determine their familiarity with eyeglass prescriptions. AARP Survey, J–37(b) (Attachment to Statement of E. Eggan, Director, American Ass'n. of Retired Persons).

[181] The Market Facts Study concludes that 44% of refractionists are not in compliance with the rule and that an additional 19% are only in partial compliance. See also Presiding Officer's Report, L–2, at 24–25, which concludes that noncompliance remains a problem and recommends that the rule not be modified.

[182] Little evidence was presented in response to the Commission's question regarding an "offer" requirement. Comments from parties on opposing sides of the release upon request or repeal issues generally opposed the use of an offer in lieu of their favored position.

[183] 50 FR 603 (1960).

[184] See Final Staff Report, L–1, at 283–87.

[185] Id. at 288–89.

[186] This need varies somewhat between hard and soft contact lenses. Hard lenses are ordered according to the fitter's specifications and, in many cases, are then modified or finished by the fitter on a custom basis.

[187] E. McCrary, Vice President, Maryland Optometric Ass'n, Tr. 182; G. Easton, President-elect, American Optometric Ass'n, Tr. 154; H. Haneln, Pennsylvania Optometrist, Tr. 2316–18; T. Vail, Illinois Optometrist, H–115, at 9.

[188] Some optometrists expressed fear that they could be held responsible for damage caused by lenses dispensed by others pursuant to their prescriptions and specifications. R. Saul, Florida Optometrist, H–93, at 3–4; A. Gossan, Michigan Optometrist, H–1.

[189] See Final Staff Report, L–1, at 297–99.

[190] Federal Trade Commission, Rules of Practice, § 1.14(2)(iii).

opticians are self-employed or employed in "independent" retail optical establishments.

The rule will give members of the optometric industry greater freedom to provide goods and services in the most cost-effective manner. They will be able to enter into business affiliations with nonoptometrists, own and operate several branch offices, use a trade name for their practice, and locate their practices in retail or mercantile settings. In a less-restrictive regulatory environment, they will have greater opportunity to develop innovative ways of offering services and goods to consumers. Corporations or other business entities presently selling opthalmic goods would be able to hire, lease space to, or associate with optometrists in order to offer one-stop shopping to consumers.

No direct costs would be imposed on optometrists, ophthalmologists, or opticians by the removal of state bans on commercial forms of practice. The rule would only permit, not require, providers to operate branch offices, maintain offices in mercantile locations, use trade names, or affiliate with lay corporations and individuals.

The only "costs" borne by industry members would be those created by doing business in a market where greater consumer choice stimulates more competition. The indirect effects of the rule on various industry members cannot be determined with any degree of precision, and will depend at least in part on how individual providers respond to the changing market conditions. For example, some noncommercial optometrists may be forced to adopt more cost-effective business practices or lower their prices in order to meet increased competition. In markets where commercial practice is now prohibited, it can be anticipated that commercial firms will enter.

3. *Effect on Small Entities.* The primary impact of the rule on small entities will stem from the increased competition in the vision care industry which can be anticipated as a result of the rule's deregulatory effects. The economic impact on individual small entities from increased competition in the vision care industry, although difficult to determine, could be substantial. However, the provisions of the rule that remove certain governmental restraints on commercial ophthalmic practice would permit small entities (i.e., optometrists and opticians) to engage in alternate modes of practice, including commercial practice, or to expand, should they desire to do so.

The rule could hurt some small entities and benefit others, depending on how they respond to a more competitive market. In states that currently restrict commercial practice, for example, the market will become more flexible and capable of responding to consumer demand. Those small entities that have been denied the opportunity to engage in more efficient business practices will now be able to do so.

Date from studies of the ophthalmic market indicate that this market is price elastic: that is, as prices of eye examinations and eyeglasses decline, there is a proportionately greater increase in consumption. Thus, we anticipate an increase in total expenditures for vision care products and services. However, the market will be a more competitive one. Some less efficient providers will undoubtedly lose business.

4. *Effect on Government Entities.* The rule invalidates state statutes and regulations that ban commercial forms of practice. Thus, state and local regulatory agencies would not have to bear the costs of enforcing these bans. However, other indirect costs might arise should state or local officials decide to enact new regulations in areas not covered by the rule. In addition to the costs involved in enacting such regulations, the regulatory agencies might incur additional enforcement costs.

B. Final Regulatory Analysis

The final regulatory analysis [191] of the rule has been integrated into the Statement of Basis and Purpose, as allowed by statute.[192]

Accordingly, Title 16, Part 456 of the Code of Federal Regulations is revised to read as follows:

PART 456—OPHTHALMIC PRACTICE RULES

Sec.

Authority: Section 18(a), 88 Stat. 2193, as amended 93 Stat. 95. (15 U.S.C. 57a); 80 Stat. 383; 81 Stat. 54; 88 Stat. 1561–1564; 90 Stat. 1247 (5 U.S.C. 552).

[191] The statute requires that the analysis contain (1) A statement of the need for and objectives of the rule; (2) a summary of the issues raised by public comments, a summary of the agency's assessment of such issues, and a statement of changes made in the rule as a result of these comments; and (3) a description of the significant alternatives to the rule considered and reasons for rejecting each alternative. 5 U.S.C. 604.

[192] 5 U.S.C. 605(a).

§ 456.1 Definitions.

(a) A "patient" is any person who has had an eye examination.

(b) An "eye examination" is the process of determining the refractive condition of a person's eyes or the presence of any visual anomaly by the use of objective or subjective tests.

(c) "Ophthalmic goods" are eyeglasses, or any component of eyeglasses, and contact lenses.

(d) "Ophthalmic services" are the measuring, fitting, and adjusting of ophthalmic goods subsequent to an eye examination.

(e) An "ophthalmologist" is any Doctor of Medicine or Osteopathy who performs eye examinations.

(f) An "optometrist" is any Doctor of Optometry.

(g) A "person" is any individual, partnership, corporation, association or other entity.

(h) A "prescription" is the written specifications for lenses for eyeglasses which are derived from an eye examination, including all of the information specified by state law, if any, necessary to obtain lenses for eyeglasses.

(i) "Optometric services" are any acts or practices which are included within the definition of the practice of optometry under state law.

§ 456.2 Separation of examination and dispensing.

It is an unfair act or practice for an ophthalmologist or optometrist to:

(a) Fail to provide to the patient one copy of the patient's prescription immediately after the eye examination is completed. Provided: An ophthalmologist or optometrist may refuse to give the patient a copy of the patient's prescription until the patient has paid for the eye examination, but only if that ophthalmologist or optometrist would have required immediate payment from that patient had the examination revealed that no ophthalmic goods were required;

(b) Condition the availability of an eye examination to any person on a requirement that the patient agree to purchase any ophthalmic goods from the ophthalmologist or optometrist;

(c) Charge the patient any fee in addition to the ophthalmologist's or optometrist's examination fee as a condition to releasing the prescription to the patient. Provided: An ophthalmologist or optometrist may charge an additional fee for verifying ophthalmic goods dispensed by another seller when the additional fee is imposed at the time the verification is performed; or

(d) Place on the prescription, or require the patient to sign, or deliver to the patient a form or notice waiving or disclaiming the liability or responsibility of the ophthalmologist or optometrist for the accuracy of the eye examination or the accuracy of the ophthalmic goods and services dispensed by another seller.

§ 456.3 Federal or State employees.

This rule does not apply to ophthalmologists or optometrists employed by any federal, state or local governmental entity.

§ 456.4 State bans on commercial practice.

(a) It is an unfair act or practice for any state or local governmental entity to:

(1) Prevent or restrict optometrists from entering into associations with lay persons or corporations by:

(i) Prohibiting persons other than optometrists from employing optometrists to provide optometric services to the public;

(ii) Prohibiting optometrists and persons other than optometrists from entering into partnership agreements, joint-ownership or equity-participation agreements, or profit-sharing agreements for the purpose of forming entities to provide optometric services or ophthalmic goods and services to the public;

(iii) Prohibiting optometrists and persons other than optometrists from entering into franchise agreements (including those that provide for the sharing of revenues) for the purpose of forming entities to provide optometric services or ophthalmic goods and services to the public;

(iv) Prohibiting optometrists from leasing space from persons other than optometrists to provide optometric services to the public or prohibiting optometrists from entering into leases for such space where rental payments under such leases are based on a percentage of revenues; or

(v) Prohibiting lay control over the business aspects of an optometric practice or an entity formed to provide optometric services or ophthalmic goods and services to the public;

(2) Limit the number of offices that may be owned or operated by optometrists or by entities formed by any of the agreements covered by § 456.4(a)(1) of the rule; or require that an owner of branch offices remain in personal attendance at each branch office for a specific percentage of time;

(3) Prohibit optometrists, or any entities formed by any of the agreements covered by § 456.4(a)(1) of the rule, from practicing in a pharmacy, department store, shopping center, retail optical dispensary or other mercantile location;

(4) Prohibit optometrists, or any entities formed by any of the agreements covered by § 456.4(a)(1) of the rule, from practicing or holding themselves out to the public, by advertising or otherwise, under any nondeceptive trade name, including a name other than the name shown on their licenses or certificates of registration; or require the disclosure in advertising of the names of all optometrists practicing at a given advertised location or practicing under a trade name.

(b) If any state or local governmental entity or officer violates any of the provisions of § 456.4(a)(1)–(4), that person will not be subject to civil penalty, redress, or other monetary liability under any section of the Federal Trade Commission Act.

§ 456.5 Declaration of Commission intent.

(a) The provisions of § 456.4(a)(1)–(4) are not intended to interfere with the exercise of state or local governmental authority to protect the health and welfare of the public. In exercising its authority to safeguard the health and safety of eye care consumers or to protect the public from unfair or deceptive practices or anticompetitive conduct, a state or local government can enact regulation that has the incidental effect of preventing an individual optometrist or optometric firm from engaging in a specific agreement or activity covered by § 456.4(a)(1)–(4), as long as such regulation does not distinguish between optometrists or optometric firms that engage in any of the agreements or activities enumerated in § 456.4(a)(1)–(4) and optometrists or optometric firms that do not engage in such agreements or activities. For example, the rule does not prevent states or local governments from prohibiting the location of an optometric practice in an area that could create a public health or safety hazard, or from enforcing a general zoning regulation, even though such prohibition or regulation had the incidental effect of preventing an optometrist from locating in some specific commercial location. While the rule affects state or local regulation of the business aspects of the practice of optometry, it is not intended to interfere with the authority of a state or local government to:

(1) Prohibit improper lay interference in the ophthalmic care provided a patient by an optometrist;

(2) Require that the optometric services provided at a branch office be supplied by a person qualified to do so under state or local law;

(3) Require that the identity of an optometrist be disclosed to a patient before, after, or at the time optometric services are performed;

(4) Prevent the deceptive use of trade names or prevent trade name infringement; or

(5) Establish and maintain minimum quality standards for ophthalmic goods or services.

(b) The Commission intends that this rule may be used as a defense to any proceeding of any kind that may be brought against any optometrist, or any entity formed by any agreement covered by § 456.4(a)(1) of the rule, for using a trade name, working for or affiliating with a person who is not an optometrist, operating branch offices or practicing in a mercantile location.

(c) In prohibiting the use of waivers and disclaimers of liability in § 456.2(d), it is not the Commission's intent to impose liability on an ophthalmologist or optometrist for the ophthalmic goods and services dispensed by another seller pursuant to the ophthalmologist's or optometrist's prescription.

(d) The rule, each subpart, and the Declaration of Commission Intent and their application are separate and severable.

Separate Statement of Chairman Daniel Oliver, Ophthalmic Practice Rule Statement of Basis and Purpose

When the Commission voted to promulgate the Ophthalmic Practice Rule, I questioned the use of the Federal Trade Commission rulemaking authority to strike down state laws that restrict competition in the eye care market. Based on principles of federalism, I voted against the proposed rule.

The restraints at issue are clearly anticompetitive and adversely impact consumers. They illustrate what I have said a thousand times: it is government that is the primary source of restraints on competition.

Nevertheless, I continue to believe that this harmful effect on consumers does not allow us to strike down anticompetitive state activities that are protected by the "state action" doctrine. I reiterate my conclusion that the Commission lacks the authority to promulgate the Ophthalmic Practice Rule.

[FR Doc. 89–5429 Filed 3–10–89; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 210, 240, 249, 270, and 274

[Release Nos. 33-6823; 34-26589; IC-16845; FR-35; File No. S7-8-88]

Reporting Requirements for Issuer's Change of Fiscal Year; Financial Reporting Changes; Period To Be Covered by First Quarterly Report After Effective Date of Initial Registration Statement

AGENCY: Securities and Exchange Commission.

ACTION: Final rules.

SUMMARY: The Securities and Exchange Commission ("Commission") today announced the adoption of amendments to Regulations 13A and 15D under the Securities Exchange Act of 1934 that revise the reporting and filing requirements when a domestic or foreign private issuer changes its fiscal year end or a successor issuer has a different fiscal year than its predecessor. The Commission also is adopting amendments to Form 8-K to require reporting of a change in fiscal year. New Rule 30b1-3 under the Investment Company Act of 1940 is being adopted to govern the reporting requirements for investment companies that change their fiscal year end. In addition, a new accounting Rule 3-06 and other amendments to the accounting and proxy rules relating to financial reporting are being adopted. Finally, the Commission is adopting amendments to the quarterly reporting rules that modify the period to be covered in a new registrant's first quarterly report.

EFFECTIVE DATE: April 12, 1989. The amendments to Exchange Act Rules 12b-25, 13a-10, and 15d-10, Forms 8-K, 10-K, 10-Q, 20-F, 12b-25, and N-SAR, and new Investment Company Act Rule 30b1-3 are effective for an issuer's decision to change a fiscal year end made on or after April 12, 1989. All other amendments are effective for filings made on or after April 12, 1989.

FOR FURTHER INFORMATION CONTACT: Howard P. Hodges or Joseph S. Aleknavage, (202) 272-2553, Office of the Chief Accountant of the Division of Corporation Finance, or Barbara J. Green, (202) 272-2589, Office of Disclosure Policy, Division of Corporation Finance, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. After the effective date, contact Joseph S. Aleknavage, (202) 272-2553, Office of the Chief Accountant of the Division of Corporation Finance, or Emanuel D. Strauss or Mark W. Green, (202) 272-2573, Office of Chief Counsel, Division of Corporation Finance. With respect to investment companies, contact Lawrence A. Friend, (202) 272-2106, Office of Disclosure, Division of Investment Management.

SUPPLEMENTARY INFORMATION: The Commission today announced the adoption of amendments to Rules 12b-25,[1] 13a-10,[2] 13a-13,[3] 14a-3,[4] 15d-10,[5] and 15d-13 [6] under the Securities Exchange Act of 1934 ("Exchange Act"),[7] as well as revisions to Forms 8-K,[8] 10-K,[9] 10-Q,[10] 20-F,[11] and 12b-25.[12] The Commission also is adopting a new accounting Rule 3-06 and amendments to Rule 3-12 [13] of Regulation S-X.[14] With respect to investment companies, new Rule 30b1-3 and amendments to Rules 8b-16 [15] and 30b1-2 [16] and Form N-SAR [17] under the Investment Company Act of 1940 ("Investment Company Act") [18] are being adopted.

I. Executive Summary

A. The Proposals

On June 2, 1988 the Commission issued a release proposing amendments to Exchange Act Rules 13a-10 and 15d-10, which set forth reporting requirements applicable when an issuer changes its fiscal year end.[19] The proposals were designed to update the rules, integrate them with other current periodic reporting requirements, codify staff rule interpretations, and clarify issuers' quarterly reporting obligations in change of fiscal year circumstances. The Commission also proposed a new item to Form 8-K to require reporting of a change in fiscal year and a new Investment Company Act rule to govern the reporting requirements for investment companies that change their fiscal year end. In addition, to codify staff practices, amendments were proposed to the proxy and accounting rules regarding financial reporting. Proposals also were made to amend the quarterly reporting rules to eliminate a reporting gap by modifying the period for which a new registrant's first quarter report must be filed.

A majority of the commentators on the Proposing Release were accounting firms and an accounting association.[20] All but one of the commentators expressed general support for the proposals, in whole or in part.[21] While commentators generally approved of the revision of issuers' reporting obligations in change of fiscal year circumstances, or codification of staff practices, most also had suggestions on specific aspects of the proposals.

The Commission is adopting the amendments substantially as proposed. The changes from the proposals are mainly in response to commentators' suggestions. All substantive changes from the proposals are noted and explained in the detailed discussion of the amendments in Part II below.

B. The Amendments

Prior to the amendments, Rules 13a-10 and 15d-10 required an issuer changing its fiscal year end to file an "interim report" with the Commission containing financial and other information about the "interim period" from the end of the most recently concluded fiscal year to the opening date of the new fiscal year if that period covered three or more months. Such reports were required to be filed on the form used for the issuer's annual report.

To avoid confusion with other reports, such as quarterly reports, which commonly are referred to as interim reports, under the amendments, interim reports are referred to as "transition reports" and interim periods called "transition periods." The amendments also include the following substantive revisions:

(1) Transition Reporting on Forms 10-Q and 10-K

Separate transition reports are required for all transition periods, except those of one month or less. Issuers will continue to file a transition

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[1] 17 CFR 240.12b-25.
[2] 17 CFR 240.13a-10.
[3] 17 CFR 240.13a-13.
[4] 17 CFR 240.14a-3.
[5] 17 CFR 240.15d-10.
[6] 17 CFR 240.15d-13.
[7] 15 U.S.C. 78a *et seq.*
[8] 17 CFR 249.308.
[9] 17 CFR 249.310.
[10] 17 CFR 249.308a.
[11] 17 CFR 249.220f.
[12] 17 CFR 249.322.
[13] 17 CFR 210.3-12.
[14] 17 CFR 210.1-01-.12-29.
[15] 17 CFR 270.8b-16.
[16] 17 CFR 270.30b1-2.
[17] 17 CFR 274.101.
[18] 15 U.S.C. 80a-1 *et seq.*
[19] Release No. 33-6778 (June 2, 1988) (53 FR 21670) ("Proposing Release"). Attention is directed to the Proposing Release for a detailed discussion of the proposals and their objectives.

[20] The nine comment letters received are available for public inspection and copying at the Commission's Public Reference Room (File No. S7-8-88). The commentators included five accounting firms, one accounting association, one bar association, one law firm, and one public utility holding company.

[21] The other commentator made recommendations on specific parts of the proposals but expressed neither general support nor opposition to the proposals.

report on the annual reporting form, usually Form 10–K, including audited financial statements, for transition periods of six or more months. For a transition period shorter than six months, issuers are given an option to file a transition report on either Form 10–Q, including unaudited financial statements, or Form 10–K, including audited financial statements. Information for a transition period of one month or less may be included in the issuer's report on Form 10–Q for the first quarter of the newly adopted fiscal year that ends after the date on which the issuer determined to change its fiscal year, if separate audited statements of income and cash flows covering the transition period are filed with the first annual report for the newly adopted fiscal year. If the issuer's next report is the first annual report for the newly adopted fiscal year, instead of a quarterly report, a transition period of one month or less may be covered in that annual report.

(2) Conforming the Filing Requirements of Transition Reports to the Current Requirements for Forms 10–Q and 10–K

To conform to the current filing periods for reports on Forms 10–K and 10–Q, the filing period for transition reports on Form 10–K is 90 days after the close of the transition period or the date of the determination to change the fiscal year, whichever is later, and for transition reports on Form 10–Q 45 days after the later of these two events.

(3) Codification of Staff Rule Interpretations of the Quarterly Reporting Requirements When an Issuer Changes Its Fiscal Year End

Consistent with staff practice, issuers will continue to have the option of filing quarterly reports for the transition period on the basis of either the old or new fiscal year. Also, consistent with staff rule interpretations, issuers, in most cases, will continue to be required to file a quarterly report for any quarter of the old fiscal year that ended before the date of the issuer's determination to change its year end. The amendments specify that the requirement to file quarterly reports on the new basis begins with the first quarter in the new fiscal year that ends after the issuer determined to change its year end.

(4) Clarification of Transition Reporting for Successor Issuers

Amendments to Rules 13a–10 and 15d–10 require transition reporting for all successor issuers, but only where they have a different fiscal year end from that of the predecessor. Successor issuers are required to file a transition report concerning the predecessor for any transition period between the close of the fiscal year covered by the last annual report of the predecessor and the date of succession. For a transition period of six or more months, the successor issuer must file the transition report on Form 10–K, including audited financial statements. For a transition period of less than six months, the successor issuer may opt instead to file the transition report on Form 10–Q, including unaudited financial statements. Just as for changes in fiscal year, where the transition period is one month or less, the successor issuer need not file a separate transition report, provided that the required information for the transition period is contained in a subsequent quarterly report, or if the next report is an annual report, in that annual report.

(5) Separate Transition Reporting Rules for Foreign Private Issuers

Separate provisions require a foreign private issuer with a transition period longer than six months to file a Form 20–F containing responses to all items required when the Form is used as an annual report, and including audited financial statements. For a transition period of six or fewer months, a foreign private issuer may opt instead to file a transition report on Form 20–F that includes responses to only a limited number of specified items and unaudited financial statements. Where the transition period is one month or less, a foreign private issuer is not required to file a separate transition report if the first annual report for the newly adopted fiscal year covers the transition period as well as the fiscal year.

(6) Reporting a Change in Fiscal Year on Form 8–K

New Item 8 of Form 8–K requires an issuer to report its new fiscal year end, the Form (10–K or 10–Q) on which the report covering the transition period will be filed, and the date of the determination to change its fiscal year end. The Form 8–K must be filed within 15 days after that date.

(7) Specific Provisions Regarding Filing Fees and Extensions of Time

No filing fee is required for transition reports. Amended Rule 12b–25 and amended Form 12b–25 add transition reports to those reports for which an extension of time for filing is available.

(8) Separate Rule for Transition Reporting of Investment Companies

New Investment Company Act Rule 30b1–3 provides transition reporting requirements specifically tailored to the semi-annual and annual reporting obligations of investment companies. The new Rule codifies the staff practice of requiring investment companies that change their fiscal year end to file a report on Form N–SAR within 60 days of either the close of the resulting transition period or the date of the determination to change the fiscal year end, whichever is later.

(9) Codification of Staff Practice of Permitting Reliance on Nine Months Statements

New accounting Rule 3–06 and a parallel note to Rule 14a–3(b)(1) [22] of the proxy rules codify the staff practice of accepting, under specified circumstances such as a change in fiscal year, financial statements covering a 9 to 12 month period in satisfaction of a requirement for financial statements for either one year or one year of a multiple year period.

(10) Codification of Staff Practice on Age of Audited Financial Statements in A *First-Time Registrant's Registration Statement*

To assure that timely financial statements for first-time registrants are available, amended accounting Rule 3–12 codifies the staff practice of requiring that the most recent audited financial statements in a registration statement under the Securities Act of 1933 ("Securities Act") [23] or on Form 10 [24] filed by a non-reporting company be no more than 1 year and 45 days old.

(11) Period to be Covered by First Report on Form 10–Q for First-Time Registrants

To avoid reporting gaps, amended Rules 13a–13 and 15d–13 governing quarterly reporting require a new registrant to file its first report on Form 10–Q for the first fiscal quarter following the most recent fiscal year or full quarter for which financial statements were included in its registration statement.

Examples illustrating the application of the amendments to typical reporting situations are contained in the Appendix in Part V of this Release. The examples have been modified where appropriate to reflect changes from the proposals.

[22] 17 CFR 240.14a–3(b)(1).

[23] 15 U.S.C. 77a *et seq.*

[24] 17 CFR 249.210.

II. Discussion

A. Reporting Fiscal Year Changes

1. Transition Reporting on Forms 10–Q and 10–K

The Commission is adopting amendments to Rules 13a–10 and 15d–10 [25] requiring an issuer to file separate transition reports for all transition periods, except those of one month or less. Under the prior rules, a separate transition report was not required for a transition period shorter than three months. In the Proposing Release, the Commission solicited comment on a proposed requirement of separate transition reports for all transition periods, including transition periods shorter than three months. Three commentators criticized the proposed requirement as not useful, necessary or justified by the costs, and recommended that information on such shorter transition periods be included in the issuer's next report on Form 10–Q.

The Commission has decided not to require a separate transition report for transition periods of one month or less. Where the transition period is one month or less, the Commission believes that the cost associated with filing a separate report for such a short time span outweigh the limited benefit of such reports to investors.[26] The amendments instead permit information about a transition period of one month or less to be included in the issuer's report on Form 10–Q for the first quarter of the newly adopted fiscal year that ends after the date on which the determination was made to change the fiscal year.[27] If the issuer's next report is the first annual report for the newly adopted fiscal year, the transition period may be covered in that annual report.

Separate transition reports are required for all transition periods longer than one month. As the transition period becomes longer, the investor's interest in the prompt disclosure of financial information about the transition period increases. The Commission believes that requiring transition reports for all transition periods longer than one month strikes the appropriate balance between the investment community's need for disclosure and the desire of issuers to minimize the costs of compliance.

Under the amendments, as under the prior rules, use of Form 10–K will continue to be required for transition reports for transition periods of six or more months.[28] For transition periods shorter than six months, amended Rules 13a–10 and 15d–10 give issuers the option to file transition reports on either Form 10–Q, including unaudited financial statements, or Form 10–K, including audited financial statements.[29] All information requested in the textual items of the reporting forms, as well as the required financial information, must be provided. Technical changes are being adopted, as proposed, to make the descriptions and cover sheets of and General Instructions to Forms 10–K and 10–Q consistent with the amendments.

In the Proposing Release, comment was invited on the six month cutoff. The three commentators addressing the six month cutoff favored it.[30] While the proposals would have required use of Form 10–Q for transition periods shorter than six months, two commentators favored affording issuers an option to file on either Form 10–Q or Form 10–K for such shorter transition periods so that issuers could furnish audited financial statements in the first instance. The Commission has adopted this suggested option, enabling issuers that opt to use Form 10–K to avoid the possibility of later revisions of previously published unaudited financial statements for the transition period.

Because the amendments afford issuers the option to use Form 10–K or 10–Q, the Commission has added a requirement, not contained in the proposals, that an issuer state in its Form 8–K reporting the change in fiscal year the Form (Form 10–Q or 10–K) on which the report covering the transition period will be filed.[31] This requirement will enable investors and the Commission staff to determine when information on the transition period will be available.

2. Filing Requirements for Transition Reports

To parallel the current filing requirements for Form 10–K, the amendments change the time for filing a transition report on Form 10–K from 120 to 90 days after the close of the transition period or the date of the determination to change the fiscal year, whichever is later.[32] The 90 day filing period applies to all transition reports filed on Form 10–K, regardless of the length of the transition period, and should give issuers sufficient time to have audited financial statements prepared covering transition periods of any length. To parallel the current filing requirements for Form 10–Q, an issuer that chooses to file a separate transition report on Form 10–Q must file that report within 45 days after the later of the close of the transition period or the date of the determination to change the fiscal year.[33]

3. Requirements for Changing a Fiscal Year After the Year End

Amended Rules 13a–10(a) and 15d–10(a) codify current staff rule interpretations by requiring an issuer to file an annual report for any fiscal year that ended before the date on which the issuer determined to change its fiscal year end. An issuer is required to report this date in the Form 8–K reporting its change in fiscal year.[34] In most cases, the date would be evidenced by minutes of the issuer's board of directors or an authorized committee thereof.[35] The amendments also codify the staff interpretive position that a transition report can be used only for periods of less than 12 months. Transition reports are not permitted for periods longer than 12 months because of the difficulties of constructing data for comparable periods that would be useful in understanding trends in a business.

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[25] Rule 13A–10 applies to issuers with securities registered pursuant to section 12 of the Exchange Act (15 U.S.C. 78*l*). Rule 15d–10 applies to issuers with securities registered under the Securities Act and filing Exchange Act reports pursuant to section 15(d) of the Exchange Act (15 U.S.C. 88o(d)).

[26] A change from a fiscal year ending as of the last day of the month to a 52–53 week fiscal year commencing within seven days of the month end (or from a 52–53 week to a month end) is not deemed a change in fiscal year for purposes of reporting subject to Rule 13a–10 or 15d–10 if the new fiscal year commences with the end of the old fiscal year. In such cases, a transition report would not be required. Either the old or new fiscal year could, therefore, be as short as 359 days, or as long as 371 days (372 is a leap year).

[27] *See* Part II.A.4., *infra*, amended Rules 13a–10(d) and 15d–10(d), and Appendix Examples 1.a. & 1.e.

[28] *See* amended Rules 13a–10(b) and 15d–10(b) and Appendix Examples 1.d., 1.g., & 1.h.

[29] *See* amended Rules 13a–10(c) and 15d–10(c) and Appendix Examples 1.b., 1.c., & 1.f.

[30] With a six month cutoff, the amendments allow 17 months between filing audited financial statements in the case where an issuer changes its fiscal year end with a resulting transition period of five months. For example, an issuer with a December 31 year end that changes its fiscal year in 1990 to May 31, 1990 will be permitted to file a Form 10–Q, including unaudited financial statements, covering the transition period from January 1, 1990 through May 31, 1990. The issuer will not be required to file audited financial statements until August 29, 1991, the due date for its next annual report covering the newly adopted fiscal year from June 1, 1990 through May 31, 1991. Compliance with the requirements for financial statements under the transition reporting rules will be deemed to satisfy the updating obligations under section 10(a)(3) of the Securities Act [15 U.S.C. 77j(a)(3)].

[31] For a discussion of new Item 8 of Form 8–K, *see* II.A.8., *infra*.

[32] *See* amended Rules 13a–10(b) and 15d–10(b).

[33] *See* amended Rules 13a–10(c) and 15d–10(c).

[34] *See* discussion of new Item 8 of Form 8–K at II.A.8., *infra*.

[35] Other evidence of the date could include a contemporaneous public announcement or press release.

4. Financial Reporting Requirements for Transition Periods

Under the amendments, financial statements in transition reports on Form 10–K must be audited. In contrast, unaudited financial statements are permitted in transition reports on Form 10–Q.

Under the amendments, a transition report on Form 10–K must include either financial statements, which may be unaudited, for the comparable period of the prior year, or a footnote, which may be unaudited, giving specified information for the comparable period of the prior year.[36] The prior year footnote information must state, at a minimum, revenues, gross profits, income taxes, income or loss from continuing operations before extraordinary items and cumulative effect of a change in accounting principles, and net income or loss. The effects of any discontinued operations and/or extraordinary items as classified under the provisions of generally accepted accounting principles also must be shown, if applicable. Per share data based upon such income or loss and net income or loss is required to be presented in conformity with applicable accounting standards.[37]

One commentator recommended that the amendments address whether the financial statements or footnote information for the comparable period of the prior year must be included in subsequent filings. The amendments as adopted have been changed to specify that, where called for by the time span covered, subsequent filings must include such statements or information.

Consistent with existing requirements for Form 10–Q, a transition report on Form 10–Q also is required to include financial information about the comparable period of the prior year.[38] As suggested by one commentator, the amendments as adopted state that schedules need not be filed in transition reports on Form 10–Q.[39] When an issuer files a transition report on Form 10–Q, separate audited statements of income and cash flows covering the transition period are required to be filed as part of the first annual report for the newly adopted fiscal year.[40] The annual report also must contain a separate audited balance sheet for a transition period of less than six months, if an audited balance sheet as of the end of the prior fiscal year is not filed. Further, the amendments specify that notes to the financial statements for the transition period included in the annual report may be integrated with the notes for the full fiscal period.

As discussed above, pursuant to amended Rule 13a–10(d) or 15d–10(d), in specified circumstances, an issuer may include information about a transition period of one month or less in its first quarterly report on Form 10–Q for the newly adopted fiscal year after the date of determination to change its year end, rather than in a separate transition report. If this is done, the financial statements required by Part I, which may be unaudited, must be furnished separately for the transition period as part of the Form 10–Q.[41] In addition, the issuer must file with the first annual report of the newly adopted fiscal year separate audited statements of income and cash flows covering the transition period. If the issuer's next report is a Form 10–K rather than a Form 10–Q, all of the required information for the transition period must be included in the Form 10–K.

Commentators asked for clarification of the application of the requirements of Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations," [42] of Regulation S–K [43] to transition periods. Consistent with new Rule 3–06 of Regulation S–X, as discussed below,[44] for a transition period of nine or more months, the information for full fiscal years set forth in Item 303(a) [45] will be required. For transition periods shorter than nine months, the information for interim periods set forth in Item 303(b) [46] will be required.

Similarly, when responding to Item 301 of Regulation S–K, "Selected Financial Data," [47] a transition period of nine or more months will be deemed to meet the requirement for one year of selected financial data if the data for all other periods covers the full time span required to be reported. Transition periods of less than nine months may be shown in the table of selected financial data for the last five fiscal years of the issuer (or for the life of the issuer if less) or may be shown in a footnote. The table of selected financial data should report on all periods within the time span for which information is required to be furnished, including any transition periods.

5. Quarterly Reporting When an Issuer Changes Its Fiscal Year

The amendments to Rules 13a–10 and 15d–10 are intended to clarify the requirements for filing quarterly reports in change of fiscal year circumstances.[48] The amendments codify the current staff practice of requiring issuers to file quarterly reports during the transition period. Under the amendments, companies continue to have the option of filing such quarterly reports based on the quarters of either the old or newly adopted fiscal year.[49] Under either option, an issuer still is required to file a quarterly report for any quarter of the old fiscal year that ended before the date on which the issuer determined to change its fiscal year end, except where the last day of the quarter also is the last day of the transition period.[50]

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[36] *See* amended Rules 13a–10(b) and 15d–10(b).

[37] The prior year footnote information tracks Rule 1–02(aa)) of Regulation S–X (17 CFR 210.1–02(aa), except that disclosure of income taxes is required under the amendments because such information is pertinent to understanding the fluctuations in earnings and earnings trends.

[38] *See* II.A.5., "Quarterly Reporting When an Issuer Changes Its Fiscal Year," *infra*, for a discussion of the new Note to paragraphs (c) and (e) of Rules 13a–10 and 15d–10 that addresses difficulties in providing comparable period financial information.

[39] However, schedules for such transition periods are required to be filed in subsequent annual reports on Form 10–K pursuant to Rules 5–04 (17 CFR 210.5–04), 7–05 (17 CFR 210.7–05), and 9–07 (17 CFR 210.9–07) of Regulation S–X where the income statements covering the transition period are required to be audited.

[40] *See* amended Rules 13a–10(c) and 15d–10(c).

[41] The information covering the transition period required by Part II and Item 2 of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations," may be combined with the information regarding the quarter.

[42] 17 CFR 229.303.

[43] 17 CFR 229.10–.802.

[44] *See* "Amendments to the Accounting and Proxy Rules to Permit Reliance on Nine Month Statements," Part II.B.1., *infra*.

[45] 17 CFR 229.303(a).

[46] 17 CFR 229.303(b).

[47] 17 CFR 229.301.

[48] *See* amended Rules 13a–10(e) and 15d–10(e).

[49] *See* amended Rules 13a–10(e)(2) and 15d–10(e)(2). Thus, an issuer with a December 31 year end that decides on February 1, 1990 to change its year end to October 31, 1990 has the option of filing quarterly reports either for the quarters of the old fiscal year ending March 31, June 30, and September 30, 1990 or for the periods coinciding with quarters of the new fiscal year ending January 31, April 30, and July 31, 1990. If the same issuer had decided on June 1, 1990 to change its year end to October 31, 1990, the issuer already would have filed a quarterly report for the quarter ending March 31, 1990 but still would have the option to file the quarterly reports either for the quarters of the old fiscal year ending June 30 and September 30, 1990 or for the period coinciding with the quarter of the new fiscal year ending July 31, 1990.

[50] *See* amended Rules 13a–10(e)(1) and 15d–10(e)(1). For example, an issuer with a December 31 year end that decides on October 15, 1990 to change its year end to November 30, 1990 is required to file by November 14, 1990 a quarterly report on Form 10–Q for the quarter ending September 30, 1990 of the old fiscal year. If the same issuer decided on October 15, 1990 to change its year end to September 30, 1990, the issuer is not required to file a quarterly report on Form 10–Q for the quarterly period ending September 30, 1990 of the old fiscal year, because the last day of the quarter would be the same as the last day of the transition period. In

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The amendments also specify the time by which an issuer must begin filing quarterly reports on the basis of the newly adopted fiscal year. An issuer is required to begin filing quarterly reports on the new basis with the quarterly report for the first quarter of the new fiscal year ending after the issuer determined to change its fiscal year end.[51] With respect to quarterly periods ending before the issuer's determination to change its year end, no reporting on the new basis is required.

The switch in quarterly reporting from the old to the new fiscal year may result in a period of less than three months that is not covered by a separate report on Form 10–Q. The Proposing Release stated that such a period would be covered on a cumulative basis in the next report on either Form 10–Q, Form 10–K or in a transition report, depending on when the switch occurred. One commentator noted that, under the proposals, the disclosure of some non-financial information about such a period might not be required in the next Form 10–Q and thus might be delayed, and further that it might be difficult for investors to derive financial information about such a period from cumulative financial information disclosed in the next Form 10–Q or other later reports.

The amendments as adopted have been modified to specify that, unless such a period of less than three months is or will be covered in the issuer's transition report or in the first annual report on Form 10–K for the newly adopted fiscal year, information (*e.g.*, legal proceedings, changes in securities) about such period must be included in the issuer's initial report on Form 10–Q for the newly adopted fiscal year.[52] Separate financial statements covering such period, which may be unaudited, must be furnished therewith.[53] These modifications do not require any additional reports, only that the financial information also be set out separately, and not just cumulatively.

The amendments also specify when recasting of prior year quarterly financial information is not required for an issuer that changes to a new fiscal year end that does not coincide with the end of a quarter of the previous fiscal year. A new Note to paragraphs (c) and (e) of Rules 13a–10 and 15d–10 permits an issuer to file quarterly reports for the quarters of the new fiscal year without recasting data for the prior fiscal year, where recasting either is not practicable or cannot be cost-justified, if the issuer furnishes (1) financial statements for the quarters of the preceding fiscal year most nearly comparable to the quarters in the newly adopted fiscal year; (2) an adequate discussion of seasonal and other factors that could affect the comparability of information or trends reflected; (3) an assessment of the comparability of the data; and (4) a representation as to the reason the recasting has not been undertaken. The Note also applies to prior year information in transition reports on Form 10–Q.[54]

6. Transition Reporting for Successor Issuers

Amended Rules 13a–10(f) and 15d–10(f) specify transition reporting requirements for successor issuers with a different fiscal year end from that of the predecessor. No transition report is required where the successor issuer and the predecessor have the same fiscal year end. Under such circumstances, the successor issuer continues to report on the same reporting schedule as that of the predecessor.[55]

While former Rule 13a–10 specified reporting requirements only for successor issuers with securities registered on Form 8–B,[56] the amendments cover all successor issuers.[57] Although former Rule 15d–10 had no provision covering transition reporting for successor issuers, the amendments add such a provision to cover companies with reporting obligations pursuant to section 15(d).[58]

Under the amendments, the transition reporting requirements for successor issuers correspond generally to the transition reporting rules applicable when other issuers change their fiscal year. The principal difference is the period to be covered in the transition report. The period to be reported on by a successor issuer ends on the date of the succession, rather than on the day prior to the beginning of the newly adopted year, in order to reflect the predecessor's operations separately from those of the successor.[59]

For a transition period of six or more months, the amendments require a successor issuer to file a transition report on Form 10–K, including audited financial statements, within 90 days after the date of the succession.[60] For a transition period shorter than six months, the successor issuer has the option to file the transition report on either Form 10–K, including audited financial statements, within 90 days after the date of the succession, or Form 10–Q, including unaudited financial statements, within 45 days after the date of the succession.[61] If the transition report is filed on Form 10–Q, the next annual report of the successor issuer must include audited statements of income and cash flows for the transition period. For a transition period of one month or less, no separate transition report is required, provided that information on the transition period is included in the successor issuer's report on Form 10–Q for the first quarter that ends after the date of the succession, or if the successor issuer's next report is an annual report, in that annual report.

These amendments, which give an issuer the option to use either Form 10–K or Form 10–Q for transition periods

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the event, a transition report on Form 10–K is required to be filed within 90 days after October 15, 1990 to cover the transition period from January 1, 1990 through September 30, 1990.

[51] See amended Rules 13a–10(e)(3) and 15d–10(e)(3). In the first example in footnote 50, a Form 10–Q is required for the first quarter (ending February 28, 1991) of the new fiscal year.

[52] The information covering the transition period required by Part II and Item 2 of Part I, "Management's Discussion and Analysis of Financial Condition and Results of Operations," may be combined with the information regarding the quarter.

[53] *See* amended Rules 13a–10(e)(4) and 15d–10(e)(4) and Appendix Example 1.e. For example, an issuer with a December 31 year end decides on June 1, 1990 to change its year end to October 31, 1990 and begins filing quarterly reports based on the quarters of the new fiscal year with the quarterly report for the quarter ending July 31, 1990. Under the amendments, the period from April 1 through April 30, 1990 would not be covered by a separate report on Form 10–Q. That period would be required to be covered in the quarterly report filed for the quarter ending July 31, 1990, and separate financial statements covering April 1 through April 30, 1990 would be required to be filed with that quarterly report.

[54] The amendments do not require an issuer that decides to change its year end after having filed quarterly reports based on the old fiscal year to file new Form 10–Qs for those quarters of the new fiscal year already concluded. However, pursuant to Item 302(a)(5) of Regulation S–K [17 CFR 229.302(a)(5)], specified issuers must provide selected financial data for each full quarter of the two most recent fiscal years in their annual reports on Form 10–K. Accordingly, the first annual report on Form 10–K of such an issuer after a fiscal year change would be required to contain historical quarterly information on the basis of the new fiscal year.

[55] *See* Rules 12g–3 (17 CFR 240.12g–3) and 15d–5 (17 CFR 240.15d–5).

[56] 17 CFR 249.208b. Form 8–B is a registration form principally used for the securities of an issuer that has no registered securities but has succeeded to an issuer with registered securities.

[57] Thus, successions reported on Form 8–K, as well as on Form 8–B, are covered. *See* Release No. 34–9072 (February 10, 1971) (36 FR 3804). Rule 12b–2 (17 CFR 240.12b–2) defines succession and, correlatively, successor.

[58] *See* amended Rule 15d–10(f).

[59] Where the successor issuer and the predecessor have a different fiscal year end and the succession is solely for the purpose of forming a holding company or changing the state of incorporation, the succession will be viewed as any change in fiscal year and not subject to the provisions of amended Rules 13a–10(f) and 15d–10(f).

[60] *See* amended Rules 13a–10(f) and 15d–10(f) and Appendix Example 2.b.

[61] *See* amended Rules 13a–10(f) and 15d–10(f) and Appendix Example 2.a.

shorter than six months, differ from the proposals, which would have required a successor issuer to file a transition report on Form 10–Q for such shorter transition periods. Like the option afforded other issuers that change their fiscal year, the option is available to successor issuers so that they may furnish audited financial statements covering the transition period in the first instance, and avoid the possibility of revision in a later audit of previously released unaudited financial information about the transition period.[62]

7. Transition Reporting for Foreign Private Issuers

The Commission is adopting separate transition reporting provisions for foreign private issuers. The separate provisions provide specific guidelines for foreign private issuers in change of fiscal year circumstances and are consistent with other separate reporting requirements and separate reporting forms for such issuers. In addition, given the varied reporting requirements and practices in foreign jurisdictions, in appropriate cases, the Commission staff will consider requests to modify the transition reporting requirements for foreign private issuers to take account of varying domicile country reporting requirements and practices.

Under amended Rules 13a–10(g) and 15d–10(g), a foreign private issuer is required to file a Form 20–F to report on all transition periods, except those of one month or less. Where the transition period is longer than six months, such issuer is required to file a transition report on Form 20–F that contains responses to all items required when the form is used as an annual report and includes audited financial statements.[63] For transition periods of six or fewer months, the amendments give a foreign private issuer an option similar to that given domestic issuers. The foreign private issuer may file its transition report on Form 20–F, either with responses to all items required when Form 20–F is used as an annual reporting form and including audited financial statements, or, in the alternative, with responses to a limited number of specified items and including unaudited financial statements.[64] The Commission has determined not to require a foreign private issuer to file a separate transition report for a transition period of one month or less if the first annual report for the newly adopted fiscal year covers the transition period as well as the fiscal year. As with domestic issuers, the costs associated with filing separate transition reports for such limited periods of one month or less are not justified by the minimal benefit to investors.

In the Proposing Release, the Commission proposed the same cutoff for foreign private issuers as domestic issuers. The Commission, however, has determined to adopt for foreign private issuers a different cutoff from that used for domestic issuers. While domestic issuers have the option to file transition reports on Form 10–Q with unaudited financial statements only for transition periods shorter than six months, foreign private issuers have the option of filing an abbreviated Form 20–F with unaudited financial statements for transition periods of six or fewer months. The different cutoff for foreign private issuers is adopted to be consistent with the reporting practices of some foreign private issuers, which develop interim financial statements that cover semi-annual periods pursuant to the laws or practices of their domicile country or rules of exchanges upon which their securities are traded.[65]

Under the amendments, a transition report on Form 20–F with responses to only the selected items and unaudited financial statements is required to be filed within three months after the close of the transition period or the date of the determination to change the fiscal year, whichever is later. A transition report on Form 20–F with responses to all items required when the form is used as an annual report and including audited financial statements must be filed within six months after the later of these two events. This six-month filing period parallels the filing period for annual reports on Form 20–F.

In the Proposing Release, the Commission solicited comment on whether foreign private issuers should be excused from providing unaudited financial statements in transition reports if they are not required to develop such statements under the laws or practices of their domicile country, or any exchange upon which their securities trade. While two commentators agreed with the exception, the Commission is not adopting the exception as part of Rules 13a–10(g) and 15d–10(g). Because the financial reporting practices of foreign private issuers vary, the Commission had determined that requests for such an exception will be considered by the staff in appropriate circumstances, particularly where an issuer can demonstrate that developing such financial data would not be practicable or cost-justified.[66]

8. Reporting Fiscal Year Changes on Form 8–K

The Commission also is adopting amendments to require an issuer to report on a Form 8–K its decision to adopt a new fiscal year in response to a new Item 8. Formal notice of a change in reporting periods should eliminate confusion and misapprehension as to the reasons for issuer's financial reports not being filed and provide an orderly and reliable mechanism for getting news of the change to investors.

Under the amendments, the issuer must report both the date of its determination to change its fiscal year end and the date of its new fiscal year end.[67] In addition, to accommodate the option to file either a Form 10–K or Form 10–Q covering a transition period shorter than six months,[68] the amendments as adopted are modified to require the issuer to state in its Form 8–K the particular Form on which the report covering the transition period will be filed. This information should be available at the time of filing the Form 8–K because of the planning required for an audit.[69] The report on Form 8–K must

[62] Other current reporting requirements for successor issuers and the Division's current interpretive positions respecting disclosures by successor issuers are not affected. As noted in the Proposing Release, when there is a change in accounting basis between the successor and predecessor, the quarterly or annual report for the period in which the succession occurs is required to present separately the statements of income and cash flows to reflect the periods prior and subsequent to the succession.

[63] Form 20–F generally is used by foreign private issuers as a registration statement, as well as an annual report. General Instruction G(b) of Form 20–F specifies that an annual report on Form 20–F shall include the information specified in Parts I, III and IV of the Form.

[64] The items, which cover most of the subjects covered in a Form 10–Q, are: Item 3, "Legal Proceedings;" Item 9, "Management's Discussion and Analysis of Financial Condition and Results of Operations;" Item 15, "Defaults Upon Senior Securities;" Item 16, "Changes in Securities and Changes in Security for Registered Securities;" and either Item 17 or 18, "Financial Statements."

[65] *Cf.* Release No. 34–24634 (June 23, 1987) (52 FR 24230) in which the Commission approved proposed rule changes by the American and New York Stock Exchanges permitting the exchanges to waive or modify specified listing standards for foreign securities. The Commission noted that the proposals would permit some foreign companies to report interim earnings on a semi-annual rather than quarterly basis.

[66] *See* Rule 3–13 of Regulation S–X (17 CFR 210.3–13), which allows the Commission to waive the filing of financial statements upon informal written request of an issuer and where consistent with the protection of investors.

[67] *See* discussion of the provisions of changing a fiscal year after the end of that particular year at II.A.3., *supra.*

[68] *See* discussion at II.A.1., "Transition Reporting on Forms 10–Q and 10–K," *supra.*

[69] If the issuer decides later to file the report covering the transition period on a form different from the form specified in its Form 8–K reporting the change in fiscal year, the issuer should file an amended Form 8–K stating the change.

be filed within 15 days after the date of the issuer's determination to change its fiscal year end.

9. Filing Fees and Extensions of Time

Amendments to Rules 13a–10 and 15d–10 make it explicit that no filing fee is required for a transition report.[70] Amendments to Rule 12b–25, Form 12b–25, and the description of the Form also are being adopted that add transition reports to those reports for which an extension of time for filing is available.[71] Consistent with the extension periods for Forms 10–K and 10–Q, the extension for a transition report on Form 10–K or 20–F is 15 calendar days after the due date and extension for a transition report on Form 10–Q is five calendar days after the due date.

10. Transition Reporting for Investment Companies

Instead of filing annual and quarterly reports on Forms 10–K and 10–Q, registered management investment companies file semi-annual reports on Form N–SAR, while unit investment trusts file only annual reports on Form N–SAR.[72] Therefore, the Commission is (1) exempting registered investment companies from Rules 13a–10 and 15d–10,[73] and (2) adopting a new Rule under the Investment Company Act specifying their transition reporting obligations.[74] The new Rule requires investment companies that change their fiscal year end to file a report on Form N-SAR within 60 days after either the close of the resulting transition period or the date of the determination to change the fiscal year end, whichever is later.[75]

Under the amendments, the transition report filed by a management investment company must cover a period no longer than six months, which is the period ordinarily covered by a report on Form N–SAR.[76] The new Rule does not specify the period the transition report must cover and, in certain circumstances, an investment company has a choice between two periods.[77] Like the amendments to Rules 13a–10 and 15d–10, new rule 30bl–3 specifies that no filing fee is required for a transition report.[78]

B. Other Financial Reporting Changes

1. Amendments to the Accounting and Proxy Rules to Permit Reliance on Nine Month Statements

The Commission is adopting new Rule 3–06 of Regulation S–X, which provides that, where the issuer has changed its fiscal year, the filing of financial statements covering a period of nine to 12 months will be deemed to satisfy a requirement for one year of financial statements.[79] The new Rule also provides that, where there is a requirement for filing financial statements for a multiple year period that does not exceed three consecutive years,[80] the filing of financial statements that include one period of nine to 12 months will be deemed to satisfy a filing requirement of one year, if for all other years in the time period financial statements covering the full years are provided.[81] The new Rule applies to financial statements in proxy and information statements, registration statements and Exchange Act reports. A parallel provisions is added to the proxy rules in the form of a new Note 2 to Rule 14a–3(b)(1).[82] The note, which tracks the language of new Rule 3–06,[83] provides that separate audited financial statements covering two years and one period of nine to twelve months fulfill the requirement for statements of income and cash flows for the three most recent fiscal years.[84] Registered investment companies, however, are not covered by the proposed new Rule and Note because they are subject to different reporting requirements.[85]

2. Amendment to Rule 3–12

To assure more timely financial statements of first-time issuers, the Commission is adopting an amendment to Rule 3–12 of Regulation S–X.[86] The amendment, which codifies staff practice, specifies that the registrant's most recent audited financial statements in a registration statement filed under the Securities Act or on Form 10 under the Exchange Act that relates to the securities of a non-reporting issuer may not be more than one year and 45 days old at the date of effectiveness of the registration statement.[87] Prior to the amendments, by changing its fiscal year end, an issuer that was not a reporting company before filing a registration statement could have attempted to file and have declared effective a registration statement with financial

[70] *See* amended Rules 13a–10(i) and 15d–10(i).

[71] *See* amended Rule 12b–25(a) and (b)(2)(ii).

[72] *See* Rules 30a–1 and 30bl–1 under the Investment Company Act (17 CFR 270.30a–1 and 270.30bl–1). Form N–SAR is filed under both the Exchange Act and the Investment Company Act.

[73] *See* amended Rules 13a–10(h) and 15d–10(h).

[74] *See* new Investment Company Act Rule 30bl–3. Investment companies electing to be regulated as business development companies must comply with the Exchange Act periodic reporting requirements applicable to entities other than investment companies, including the filing of Forms 10–K and 10–Q. Accordingly, such companies are subject to the provisions of Exchange Act Rules 13a–10 and 15d–10 rather than new Investment Company Act Rule 30bl–3.

[75] Investment companies filing Form N–SAR must do so within 60 days of the end of the reporting period. *See* Rule 30bl–1.

[76] The rule does not provide for a transition report for unit investment trusts which, regardless of their fiscal year ends, are required to file Form N–SAR for a 12-month period ending December 31.

[77] A management investment company making a determination on January 15 to change its fiscal year end from December 31 to February 28 cannot file a report for the period from July 1 to February 28 because the period would be longer than six months. Rather, the investment company must file a report, no later than 60 days after January 15, either (1) covering the transition period beginning July 1 and ending August 31 or (2) covering the period from July 1 to December 31, and then file, no later than 60 days after February 28, a report for the transition period from January 1 to February 28.

[78] Form N–SAR is amended to provide an instruction for transition reporting. In addition, the Commission is adopting technical amendments to Rules 8b–16 and 30bl–2 and Form N–SAR under the Investment Company Act to correct erroneous references to Rule 30bl–3. The references are changed to Rule 30b1–1 which, until 1985, was designated as Rule 30bl–3. *See* Release No. 33–6591 (July 1, 1985) (50 FR 27940).

[79] See Rule 3–05(b) of Regulation S–X (17 CFR 210.3–05(b)) and Rule 14a–3(b)(1) of the proxy rules. Rule 3–05(b) is referred to in Form 8–K under the Exchange Act and applicable to the Securities Act registration statement forms (except Form S–18 (17 CFR 239.28) and those forms filed by investment companies).

[80] See Rules 3–02(a) (17 CFR 210.3–02(a)) and 3–05(b) of Regulation S–X, Rule 14a–3(b)(1) of the proxy rules, and Item 21(d) of Form S–18. The Securities Act registration statement forms (except Form S–18) and Exchange Act Forms 8–K, 10, and 10–K all require financial statements prepared in accordance with Regulation S–X.

[81] Where there has been a significant acquisition by the issuer, new Rule 3–06 also permits the filing of financial statements of the company being acquired covering a period of nine to 12 months in satisfaction of a requirement for one year of financial statements, if the required financial statements for all other periods cover the full time span. In addition, under the amendments, the filing of financial statements covering a period of nine to 12 months satisfies a requirement for one year of financial statements where the Commission so permits pursuant to Rule 3–13 of Regulation S–X.

[82] This provision also applies to information statements. See Rule 14c–3(a)(1) (17 CFR 240.14c–3(a)(1)), which requires that the information specified in Rules 14a–3(b)(1) through (b)(11) (17 CFR 240.14a–3(b)(1)—(11)) also be given to shareholders who receive information statements.

[83] The wording of the amendment has been changed from the proposals to parallel new Rule 3–06 more closely.

[84] Three commentators raised the issue of restatement of prior period financial statements. As in the past, the staff will continue to accept in annual reports on Form 10–K and annual reports to shareholders the restatement of prior period financial statements to conform with an issuer's newly adopted fiscal year, although such restatement will not be required.

[85] See Rule 3–18 of Regulation S–X (17 CFR 210.3–18).

[86] *See* new paragraph (d); former paragraphs (d) and (e) have been redesignated.

[87] The wording of the amendment has been modified to clarify that the one year and 45 day rule does not apply to financial statements other than those of the registrant.

statements up to 18 and one-half months old.[88]

The amendment applies only to companies not yet in the Exchange Act reporting system because their financial and business history is not available to investors and the marketplace. As noted in the Proposing Release, the one year and 45 day cutoff for the age of non-reporting company financial statements is consistent with those requirements of Rule 3–01 of Regulation S–X that limit the age of the financial statements in a registration statement of a company that previously has not been reporting pursuant to the requirements of the Exchange Act.[89]

C. Quarterly Reporting: First Report to be Filed on Form 10–Q

Finally, the Commission is adopting amendments to Rules 13a–13 and 15d–13 to eliminate any gap in the reporting period between the financial information included in a registration statement and the first report on Form 10–Q.[90] Under the amendments, the requirement to file quarterly reports commences with the first fiscal quarter following the most recent fiscal year or full quarter for which financial statements were included in the registration statement.[91] A first-time registrant is required to file its first Form 10–Q the later of 45 days after the effectiveness of the registration statement, or the date on which such report would have been required to be filed if the issuer had been a reporting company as of its last fiscal quarter. Prior to the amendments, an issuer's first report on Form 10–Q was required to be filed commencing with the first quarter ending after the effective date of its first registration statement.[92]

As is currently the case, first-time registrants generally will continue to be required to commence filing quarterly reports at the time specified, regardless of whether they have operations during this period.[93]

III. Cost-Benefit Analysis

In the Proposing Release, the Commission requested commentators to provide views and data as to the costs and benefits associated with the proposed amendments to Exchange Act Rules 12b–25, 13a–10, 14a–3, and 15d–10, Forms 8–K, 10–K, 10–Q, 20–F, and 12b–25, proposed new Investment Company Act Rule 30b1–3, the proposed amendments to Investment Company Act Rules 8b–16 and 30b1–2 and Form N–SAR, proposed new Rule 3–06 and the proposed amendment to Rule 3–12 of Regulation S–X.

Four commentators expressed views specifically on the costs and benefits associated with the reporting requirements for transition periods shorter than three months. One commentator believed that the requirement of separate transition reports for such shorter transition periods would not be cost beneficial as data concerning such periods would not be accompanied by similar disclosure for comparable historical periods. Another commentator that found the requirement unnecessary stated that the additional costs of such reports would not be substantial, but that the benefits would decrease as the transition period becomes shorter. As noted above in Part II.A.1., the amendments as adopted do not require a separate transition report for transition periods of one month or less.

Two other commentators expressed concerns that the costs of presenting audited financial statements covering shorter transition periods of less than three months in the first annual report of the newly adopted fiscal year would outweigh the benefits because of the short period covered and because such audited financial statements would be over one year old when presented. The amendments have not modified substantially the former rules in this regard.

The Commission also requested views and data as to the costs and benefits associated with amending Rules 13a–13 and 15d–13 to require a new registrant to file its first report on Form 10–Q for the first quarterly period other than the fourth quarter ending after the annual or quarterly period covered by the most recent financial statements included in its effective registration statement. The Commission noted that this revision should benefit investors by providing more timely and complete financial information about a first-time registrant for the period following the latest financial information in an effective registration statement. No comments were received on the costs and benefits associated with these amendments.

IV. Final Regulatory Flexibility Analysis

A Final Regulatory Flexibility Analysis in accordance with 5 U.S.C. 604 has been prepared concerning the proposed amendments to Exchange Act Rules 12b–25, 13a–10, 13a–13, 14a–3, 15d–10, and 15d–13, Forms 8–K, 10–K, 10–Q, 20–F, and 12b–25, proposed new Investment Company Act Rule 30b1–3 and the proposed amendments to Investment Company Act Rules 8b–16 and 30b1–2 and Form N–SAR, proposed new Rule 3–06 and the proposed amendment to Rule 3–12 of Regulation S–X. Members of the public who wish to obtain a copy of the Final Regulatory Flexibility Analysis should contact Barbara J. Green, (202) 272–2589, Office of Disclosure Policy, Division of Corporation Finance, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. A summary of the corresponding Initial Regulatory Flexibility Analysis appears at 53 FR 21670 (Release No. 33–6778).

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[88] Rule 3–01(b) of Regulation S–X (17 CFR 210.3–01(b)) has permitted specified registrants to use unaudited financial statements that are at least as current as the third fiscal quarter of the most recently completed fiscal year if their registration statement is filed within 45 days after the end of the most recent fiscal year. Thus, under the former rules, a first-time registrant under the Securities Act with a December 31, 1986 year end that changed its year end in 1987 to May 31, 1987 could have filed unaudited financial statements covering the transition period from January 1, 1987 through May 31, 1987 and unaudited financial statements covering the subsequent nine months ending February 29, 1988 in a registration statement and attempted to have that registration statement declared effective on July 14, 1988. The most recently audited financial statements in the registration statement would have covered the year ending December 31, 1986.

[89] Rule 3–01(b) provides that the audited financial statements of the prior fiscal year may not be used more than 45 days after the end of the current fiscal year, unless the specified circumstances in Rule 3–01(c) (17 CFR 210.3–01(c)) exist, which include the requirement that the registrant be filing reports pursuant to Section 13 (15 U.S.C. 78m) or 15(d). In addition, Rule 3–01(a) (17 CFR 210.3–01(a)) requires a registrant that has been in existence for less than one fiscal year to file audited financial statements within 135 days of the date of filing the registration statement.

[90] *Cf.* Rule 15d–2 (17 CFR 240.15d–2), which eliminates a similar reporting gap by requiring an issuer whose registration statement becomes effective after a fiscal year end without audited financial statements as of such fiscal year end in the prospectus to file a special report within 90 days of effectiveness on the form appropriate for annual reports of the registrant. The special report must include audited financial statements for the last full fiscal year.

[91] *See* amended Rules 13a–13(a) and 15d–13(a).

[92] For example, under the amendments, a registrant with a December 31 year end whose registration statement became effective on April 14, 1990 including financial statements as of December 31 of the prior year, is required to file a quarterly report for the quarter ending March 31, 1990. The quarterly report is not due until 45 days after April 14, 1990, the date of effectiveness. Under the former rules, the same registrant would not have been required to file a quarterly report for the quarter ending on March 31, 1990. The former rules only would have required its first quarterly report for the quarter ending June 30, 1990.

[93] Generally, the staff has taken the position that registrants under the Securities Act whose registration statements are declared effective shortly before the end of their fiscal year, thereby creating Exchange Act reporting requirements pursuant to section 15(d), are required to file annual and quarterly reports even where the registrant has not commenced operations; for example, where the registrant is in the process of a best efforts offering and has not yet met the minimum, or where an acquisition by the registrant has not yet been completed pending regulatory approval.

V. Appendix

1. Examples of Reporting Under the Amendments for a Domestic Issuer with a Dec. 31 Year End that Files Periodic Reports Pursuant to Section 13 or 15(d) of the Exchange Act

a. Decision made early in year to change year end to date already past with resulting transition period of one month or less:

On March 1, 1990 the issuer decides to change year end to Jan. 31, 1990
—15 days after March 1, 1990 files an 8–K
—90 days after Dec. 31, 1989 files a 10–K covering full year from Jan. 1, 1989 through Dec. 31, 1989
—At the option of the issuer, it may file a separate transition report on Form 10–Q 45 days after March 1, 1990 covering the transition period from Jan. 1, 1990 through Jan. 31, 1990
—At the option of the issuer, it may file a separate transition report on Form 10–K 90 days after March 1, 1990 covering the transition period from Jan. 1, 1990 through Jan. 31, 1990
—45 days after April 30, 1990 files a 10–Q covering the first quarter ending April 30, 1990 of the new fiscal year; if the issuer has not opted to file a separate transition report on either Form 10–Q or 10–K, the 10–Q for the quarter ending April 30, 1990 must cover the transition period from Jan. 1, 1990 through Jan. 31, 1990 and include separate financial statements, which may be unaudited, for the transition period from Jan. 1, 1990 through Jan. 31, 1990
—45 days after July 31, 1990 and Oct. 31, 1990 files 10–Qs covering the quarters ending July 31, 1990 and Oct. 31, 1990 of the new fiscal year, respectively
—90 days after Jan. 31, 1991 files a 10–K covering the full year from Feb. 1, 1990 through Jan. 31, 1991, with regular timing of quarterly and annual reporting continuing thereafter; if the issuer filed a separate transition report on Form 10–Q or the transition period information was included in 10–Q for the quarter ending April 30, 1990, the 10–K must include separate audited financial statements covering the transition period from Jan. 1, 1990 through Jan. 31, 1990

b. Decision made early in year to change year end to date already past with resulting transition period shorter than six months but longer than one month:

On March 1, 1990 the issuer decides to change year end to Feb. 28, 1990
—15 days after March 1, 1990 files an 8–K
—90 days after Dec. 31, 1989 files a 10–K covering full year from Jan. 1, 1989 through Dec. 31, 1989
—Either 45 days after March 1, 1990 files a transition report on Form 10–Q or 90 days after March 1, 1990 files a transition report on Form 10–K covering the transition period from Jan. 1, 1990 through Feb. 28, 1990
—45 days after May 31, 1990 files a 10–Q covering the first quarter ending May 31, 1990 of the new fiscal year, with regular timing of quarterly and annual reporting continuing thereafter; if the transition report was filed on Form 10–Q, the 10–K covering the full year from March 1, 1990 through Feb. 28, 1991 must include separate audited financial statements covering the transition period from Jan. 1, 1990 through Feb. 28, 1990

c. Decision made early in year to change year end to future date with resulting transition period shorter than six months but longer than one month:

On Feb. 1, 1990 the issuer decides to change year end to May 31, 1990
—15 days after Feb. 1, 1990 files an 8–K
—90 days after Dec. 31, 1989 files a 10–K covering full year from Jan. 1, 1989 through Dec. 31, 1989
—Either 45 days after Feb. 28, 1990 files a 10–Q covering the period ending Feb. 28, 1990 coinciding with a quarter of the new fiscal year or 45 days after March 31, 1990 files a 10–Q covering the quarter ending March 31, 1990 of the old fiscal year
—Either 45 days after May 31, 1990 files a transition report on Form 10–Q or 90 days after May 31, 1990 files a transition report on Form 10–K covering the transition period from Jan. 1, 1990 through May 31, 1990
—45 days after Aug. 31, 1990 files a 10–Q covering the first quarter ending Aug. 31, 1990 of the new fiscal year, with regular timing of quarterly and annual reporting continuing thereafter; if the transition report was filed on Form 10–Q, the 10–K covering the full year from June 1, 1990 through May 31, 1991 would include separate audited financial statements covering the transition period from Jan. 1, 1990 through May 31, 1990

d. Decision made early in year to change year end to future date with resulting transition period six months or longer:

On Feb. 1, 1990 the issuer decides to change year end to Sept. 30, 1990
—15 days after Feb. 1, 1990 files an 8–K
—90 days after Dec. 31, 1989 files a 10–K covering full year from Jan. 1, 1989 through Dec. 31, 1989
—45 days after March 31, 1990 and June 30, 1990 files 10–Qs covering the quarters ending March 31, 1990 and June 30, 1990, respectively
—90 days after Sept. 30, 1990 files a transition report on Form 10–K covering the transition period from Jan. 1, 1990 through Sept. 30, 1990
—45 days after Dec. 31, 1990 files a 10–Q covering the first quarter ending Dec. 31, 1990 of the new fiscal year, with regular timing of quarterly and annual reporting continuing thereafter

e. Decision made late in year to change year end to date already past with resulting transition period of one month or less:

On Sept. 1, 1990 the issuer decides to change year end to Jan. 31, 1990
—15 days after Sept. 1, 1990 files an 8–K
—At the option of the issuer, it may file a separate transition report on Form 10–Q 45 days after Sept. 1, 1990 covering the transition period from Jan. 1, 1990 through Jan. 31, 1990
—At the option of the issuer, it may file a separate transition report on Form 10–K 90 days after Sept. 1, 1990 covering the transition period from Jan. 1, 1990 through Jan. 31, 1990
—45 days after Oct. 31, 1990 files a 10–Q covering the quarter ending Oct. 31, 1990 of the new fiscal year; if the issuer has not opted to file a separate transition report on either Form 10–Q or 10–K, the 10–Q for the quarter ending Oct. 31, 1990 must cover the transition period from Jan. 1, 1990 through Jan. 31, 1990 and include separate financial statements, which may be unaudited, covering the transition period from Jan. 1, 1990 through Jan. 31, 1990; the 10–Q for the quarter ending Oct. 31, 1990 also must cover and include separate financial statements for the period from July 1, 1990 through July 31, 1990
—90 days after Jan. 31, 1991 files a 10–K covering the full year from Feb. 1, 1990 through Jan. 31, 1991, with regular timing of quarterly and annual reporting continuing thereafter; if the issuer filed a separate transition report on Form 10–Q or the transition period information was included in the 10–Q for the quarter ending Oct. 31, 1990, the 10–K must include audited financial statements covering the transition period from Jan. 1, 1990 through Jan. 31, 1990

f. Decision made late in year to change year end to date already past with resulting transition period shorter than six months but longer than one month:

On Nov. 1, 1990 the issuer decides to change year end to Feb. 28, 1990
—45 days after Sept. 30, 1990 files an 10–Q covering the quarter ending Sept. 30, 1990 of the old fiscal year
—15 days after Nov. 1, 1990 files an 8–K
—Either 45 days after Nov. 1, 1990 files a transition report on Form 10–Q or 90

days after Nov. 1, 1990 files a transition report on Form 10–K covering the transition period from Jan. 1, 1990 through Feb. 28, 1990
—45 days after Nov. 30, 1990 files a 10–Q covering the quarter ending Nov. 30, 1990 of the new fiscal year
—90 days after Feb. 28, 1991 files a 10–K covering full year from March 1, through Feb. 28, 1991, with regular timing of quarterly and annual reporting continuing thereafter; if the transition report was filed on Form 10–Q, the 10–K must include separate audited financial statements covering the transition period from Jan. 1, 1990 through Feb. 28, 1990

g. Decision made late in year to change year end to date already past with resulting transition period six months or longer:

On Nov. 1, 1990 the issuer decides to change year end to Sept. 30, 1990
—15 days after Nov. 1, 1990 files an 8–K
—90 days after Nov. 1, 1990 files a transition report on Form 10–K covering the transition period from Jan. 1, 1990 through Sept. 30, 1990
—45 days after Dec. 31, 1990 files an 10–Q covering the first quarter ending Dec. 31, 1990 of the new fiscal year, with regular timing of quarterly and annual reporting continuing thereafter

h. Decision made late in year to change year end to date already past with resulting transition period six months or longer where fiscal quarters of newly adopted year do not coincide with those of old fiscal year:

On Nov. 20, 1990 the issuer decides to change year end to Aug. 31, 1990
—15 days after Nov. 20, 1990 files an 8–K
—45 days after Nov. 30, 1990 files a 10–Q covering the first quarter ending Nov. 30, 1990 of the new fiscal year
—90 days after Nov. 20, 1990 files a transition report on Form 10–K covering the transition period from Jan. 1, 1990 through Aug. 31, 1990 with regular timing of quarterly and annual reporting continuing thereafter

2. Examples of Reporting Under the Amendments for a Successor Issuer that has a Fiscal Year Different from the December 31 Year End of the Predecessor

a. Succession with resulting transition period shorter than six months but longer than one month:

The date of succession is April 30, 1990
—15 days after April 30, 1990 files an 8–K
—Either 45 days after April 30, 1990 files a transition report regarding the predecessor on Form 10–Q or 90 days after April 30, 1990 files a transition report regarding the predecessor on Form 10–K covering the transition period from Jan. 1, 1990 through April 30, 1990
—If the transition report was filed on Form 10–Q, the next annual report of the successor issuer must include audited statements of income and cash flows for the transition period

b. Succession with resulting transition period six months or longer:

The date of succession is July 31, 1990
—15 days after July 31, 1990 files an 8–K
—90 days after July 31, 1990 files a transition report regarding the predecessor on Form 10–K covering the transition period from Jan. 1, 1990 through July 31, 1990

3. Examples of Reporting Under the Amendments for a Management Investment Company Issuer With a December 31 Year End that Changes its Fiscal Year

a. On Feb. 1, 1990 decides to change the year end to April 30
—60 days after April 30 files Form N–SAR covering the period from Jan. 1 to April 30
b. On Feb. 1, 1990 decides to change the year end to Sept. 30
—60 days after March 31 files Form N–SAR covering the period from Jan. 1 to March 31
c. On April 1, 1990 decides to change the year end to Jan. 31
—60 days after April 1 files Form N–SAR covering the period from Jan. 1 to Jan. 31
d. On Oct. 1, 1990 decides to change the year end to Nov. 30
—60 days after Nov. 30 files Form N–SAR covering the period from July 1 to Nov. 30
e. On Nov. 1, 1990 decides to change the year end to Jan. 31
—60 days after Nov. 1 files Form N–SAR covering the period from July 1 to July 31
f. On Nov. 1, 1990 decides to change the year end to Sept. 30
—60 days after Nov. 1 files Form N–SAR covering the period from July 1 to Sept. 30

VI. Codification Update

The "Codification of Financial Reporting Policies" announced in Financial Reporting Release No. 1 (April 15, 1982) (47 FR 21028) is updated to:

1. Add a new § 102.05, "Issuer's Change of Fiscal Year."

2. Include in § 102.05 the text in Part I.B. of this Release, "The Amendments," and the examples set forth in Part V. "Appendix," which are cross-referenced to that text.

The Codification is a separate publication of the Commission. It will not be published in the Federal Register/Code of Federal Regulations Systems.

VII. Statutory Basis

The amendments are being adopted by the Commission pursuant to sections 7 and 19(a) of the Securities Act of 1933, sections 13, 14, 15(d), and 23(a) of the Securities Exchange Act of 1934, and sections 8, 30, and 38 of the Investment Company Act of 1940.

List of Subjects in CFR Parts 210, 240, 249, 270, and 274

Reporting and recordkeeping requirements, Securities.

VIII. Text of Amendments

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 210—FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, PUBLIC UTILITY HOLDING COMPANY ACT OF 1935, INVESTMENT COMPANY ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975

1. The authority citation for Part 210 continues to read, in part, as follows:

Authority: Secs. 6, 7, 8, 10, 19 and Schedule A of the Securities Act of 1933 (15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77aa(25) (26)) * * *

2. By adding new § 210.3–06 to read as follows:

§ 210.3–06 Financial statements covering a period of nine to twelve months.

Except with respect to registered investment companies, the filing of financial statements covering a period of 9 to 12 months shall be deemed to satisfy a requirement for filing financial statements for a period of 1 year where:

(a) The issuer has changed its fiscal year;

(b) The issuer has made a significant business acquisition for which financial statements are required under § 210.3–05 of this chapter and the financial statements covering the interim period pertain to the business being acquired; or

(c) The Commission so permits pursuant to § 210.3–13 of this chapter.

Where there is a requirement for filing financial statements for a time period exceeding one year but not exceeding three consecutive years (with not more than 12 months included in any period reported upon), the filing of financial

statements covering a period of nine to 12 months shall satisfy a filing requirement of financial statements for one year of that time period only if the conditions described in either paragraph (a), (b), or (c) of this section exist and financial statements are filed that cover the full fiscal year or years for all other years in the time period.

3. By amending § 210.3–12 by redesignating current paragraphs (d) and (e) as paragraphs (e) and (f), respectively, and adding new paragraph (d) to read as follows:

§ 210.3–12 Age of financial statements at effective date of registration statement or at mailing date of proxy statement.

* * * * *

(d) The age of the registrant's most recent audited financial statements included in a registration statement filed under the Securities Act of 1933 or filed on Form 10 (17 CFR 249.210) under the Securities Exchange Act of 1934 shall not be more than one year and 45 days old at the date the registration statement becomes effective if the registration statement relates to the security of an issuer that was not subject, immediately prior to the time of filing the registration statement, to the reporting requirements of section 13 or 15(d) of the Securities Exchange Act of 1934.

* * * * *

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read, in part, as follows:

Authority: Sec. 23, 48 Stat. 901, as amended (15 U.S.C. 78w) * * *

2. By amending § 240.12b–25 by revising paragraphs (a) and (b)(2)(ii) to read as follows:

§ 240.12b–25 Notification of inability to timely file all or any required portion of a Form 10–K, 20–F, 11–K, N–SAR or 10–Q.

(a) If all or any required portion of an annual or transition report on Form 10–K, 20–F, 11–K or a quarterly or transition report on Form 10–Q required to be filed pursuant to section 13 or 15(d) of the Act and the rules thereunder or if all or any portion of a semi-annual, annual or transition report on Form N–SAR required to be filed pursuant to section 30 of the Investment Company Act of 1940 and the rules thereunder is not filed within the time period prescribed for such report, the registrant, no later than one business day after the due date for such report, shall file a Form 12b–25 (17 CFR 249.322) with the Commission which shall contain disclosure of its inability to file the report timely and the reasons therefor in reasonable detail.

(b) * * *

(2) * * *

(ii) Either the subject annual report, semi-annual report or transition report on Form 10–K, 20–F, 11–K or N–SAR, or portion thereof, will be filed no later than the fifteenth calendar day following the prescribed due date or the subject quarterly report or transition report on Form 10–Q, or portion thereof, will be filed no later than the fifth calendar day following the prescribed due date; and

* * * * *

3. By revising § 240.13a–10 to read as follows:

§ 240.13a–10 Transition reports.

(a) Every issuer that changes its fiscal closing date shall file a report covering the resulting transition period between the closing date of its most recent fiscal year and the opening date of its new fiscal year; *Provided, however,* that an issuer shall file an annual report for any fiscal year that ended before the date on which the issuer determined to change its fiscal year end. In no event shall the transition report cover a period of 12 or more months.

(b) The report pursuant to this section shall be filed for the transition period not more than 90 days after either the close of the transition period or the date of the determination to change the fiscal closing date, whichever is later. The report shall be filed on the form appropriate for annual reports of the issuer, shall cover the period from the close of the last fiscal year end and shall indicate clearly the period covered. The financial statements for the transition period filed therewith shall be audited. Financial statements, which may be unaudited, shall be filed for the comparable period of the prior year, or a footnote, which may be unaudited, shall state for the comparable period of the prior year, revenues, gross profits, income taxes, income or loss from continuing operations before extraordinary items and cumulative effect of a change in accounting principles and net income or loss. The effects of any discontinued operations and/or extraordinary items as classified under the provisions of generally accepted accounting principles also shall be shown, if applicable. Per share data based upon such income or loss and net income or loss shall be presented in conformity with applicable accounting standards. Where called for by the time span to be covered, the comparable period financial statements or footnote shall be included in subsequent filings.

(c) If the transition period covers a period of less than six months, in lieu of the report required by paragraph (b) of this section, a report may be filed for the transition period on Form 10–Q (§ 249.308a of this chapter) not more than 45 days after either the close of the transition period or the date of the determination to change the fiscal closing date, whichever is later. The report on Form 10–Q shall cover the period from the close of the last fiscal year end and shall indicate clearly the period covered. The financial statements filed therewith need not be audited but, if they are not audited, the issuer shall file with the first annual report for the newly adopted fiscal year separate audited statements of income and cash flows covering the transition period. The notes to financial statements for the transition period included in such first annual report may be integrated with the notes to financial statements for the full fiscal period. A separate audited balance sheet as of the end of the transition period shall be filed in the annual report only if the audited balance sheet as of the end of the fiscal year prior to the transition period is not filed. Schedules need not be filed in transition reports on Form 10–Q.

(d) Notwithstanding the foregoing in paragraphs (a), (b), and (c) of this section, if the transition period covers a period of one month or less, the issuer need not file a separate transition report if either:

(1) The first report required to be filed by the issuer for the newly adopted fiscal year after the date of the determination to change the fiscal year end is an annual report, and that report covers the transition period as well as the fiscal year; or

(2)(i) The issuer files with the first annual report for the newly adopted fiscal year separate audited statements of income and cash flows covering the transition period; and

(ii) The first report required to be filed by the issuer for the newly adopted fiscal year after the date of the determination to change the fiscal year end is a quarterly report on Form 10–Q; and

(iii) Information on the transition period is included in the issuer's quarterly report on Form 10–Q for the first quarterly period (except the fourth quarter) of the newly adopted fiscal year that ends after the date of the determination to change the fiscal year. The information covering the transition period required by Part II and Item 2 of Part I may be combined with the information regarding the quarter. However, the financial statements

required by Part I, which may be unaudited, shall be furnished separately for the transition period.

(e) Every issuer required to file quarterly reports on Form 10–Q pursuant to § 240.13a–13 of this chapter that changes its fiscal year end shall:

(1) File a quarterly report on Form 10–Q within the time period specified in General Instruction A.1. to that form for any quarterly period (except the fourth quarter) of the old fiscal year that ends before the date on which the issuer determined to change its fiscal year end, except that the issuer need not file such quarterly report if the date on which the quarterly period ends also is the date on which the transition period ends;

(2) File a quarterly report on Form 10–Q within the time specified in General Instruction A.1. to that form for each quarterly period of the old fiscal year within the transition period. In lieu of a quarterly report for any quarter of the old fiscal year within the transition period, the issuer may file a quarterly report on Form 10–Q for any period of three months within the transition period that coincides with a quarter of the newly adopted fiscal year if the quarterly report is filed within 45 days after the end of such three month period, provided the issuer thereafter continues filing quarterly reports on the basis of the quarters of the newly adopted fiscal year;

(3) Commence filing quarterly reports for the quarters of the new fiscal year no later than the quarterly report for the first quarter of the new fiscal year that ends after the date on which the issuer determined to change the fiscal year end; and

(4) Unless such information is or will be included in the transition report, or the first annual report on Form 10–K for the newly adopted fiscal year, include in the initial quarterly report on Form 10–Q for the newly adopted fiscal year information on any period beginning on the first day subsequent to the period covered by the issuer's final quarterly report on Form 10–Q or annual report on Form 10–K for the old fiscal year. The information covering such period required by Part II and Item 2 of Part I may be combined with the information regarding the quarter. However, the financial statements required by Part I, which may be unaudited, shall be furnished separately for such period.

Note to paragraphs (c) and (e): If it is not practicable or cannot be cost-justified to furnish in a transition report on Form 10–Q or a quarterly report for the newly adopted fiscal year financial statements for corresponding periods of the prior year where required, financial statements may be furnished for the quarters of the preceding fiscal year that most nearly are comparable if the issuer furnishes an adequate discussion of seasonal and other factors that could affect the comparability of information or trends reflected, an assessment of the comparability of the data, and a representation as to the reason recasting has not been undertaken.

(f) Every successor issuer with securities registered under Section 12 of this Act that has a different fiscal year from that of its predecessor(s) shall file a transition report pursuant to this section, containing the required information about each predecessor, for the transition period, if any, between the close of the fiscal year covered by the last annual report of each predecessor and the date of succession. The report shall be filed for the transition period on the form appropriate for annual reports of the issuer not more than 90 days after the date of the succession, with financial statements in conformity with the requirements set forth in paragraph (b) of this section. If the transition period covers a period of less than six months, in lieu of a transition report on the form appropriate for the issuer's annual reports, the report may be filed for the transition period on Form 10–Q not more than 45 days after the date of the succession, with financial statements in conformity with the requirements set forth in paragraph (c) of this section. Notwithstanding the foregoing, if the transition period covers a period of one month or less, the successor issuer need not file a separate transition report if the information is reported by the successor issuer in conformity with the requirements set forth in paragraph (d) of this section.

(g)(1) Paragraphs (a) through (f) of this section shall not apply to foreign private issuers authorized to use Form 20–F (§ 249.220f of this chapter) for annual reports required by Rule 13a–1 (§ 240.13a–1 of this chapter).

(2) Every foreign private issuer that changes its fiscal closing date shall file a report covering the resulting transition period between the closing date of its most recent fiscal year and the opening date of its new fiscal year. In no event shall a transition report cover a period longer than 12 months.

(3) The report for the transition period shall be filed on Form 20–F responding to all items to which such issuer is required to respond when Form 20–F is used as an annual report. Such report shall be filed within six months after either the close of the transition period or the date on which the issuer made the determination to change the fiscal closing date, whichever is later. The financial statements for the transition period filed therewith shall be audited.

(4) If the transition period covers a period of six or fewer months, in lieu of the report required by paragraph (g)(3) of this section, a report for the transition period may be filed on Form 20–F responding to Items 3, 9, 15, 16, and 17 or 18 within three months after either the close of the transition period or the date on which the issuer made the determination to change the fiscal closing date, whichever is later. The financial statements required by either Item 17 or Item 18 shall be furnished for the transition period. Such financial statements may be unaudited and condensed as permitted in Article 10 of Regulation S–X (§ 210.10–01 of this chapter), but if the financial statements are unaudited and condensed, the issuer shall file with the first annual report for the newly adopted fiscal year separate audited statements of income and cash flows covering the transition period.

(5) Notwithstanding the foregoing in paragraphs (g)(2), (g)(3), and (g)(4) of this section, if the transition period covers a period of one month or less, a foreign private issuer need not file a separate transition report if the first annual report for the newly adopted fiscal year covers the transition period as well as the fiscal year.

(h) The provisions of this rule shall not apply to investment companies required to file reports pursuant to Rule 30b1–1 (§ 270.30b1–1 of this chapter) under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*).

(i) No filing fee shall be required for a transition report filed pursuant to this section.

Note.—In addition to the report or reports required to be filed pursuant to this section, every issuer, except a foreign private issuer authorized to use Form 20–F for annual reports required by Rule 13a–1 or an investment company required to file reports pursuant to Rule 30b1–1 under the Investment Company Act of 1940, that changes its fiscal closing date is required to file a report on Form 8–K responding to Item 8 thereof within the period specified in General Instruction B.1. to that form.

4. By amending § 240.13a–13 by revising paragraph (a) to read as follows:

§ 240.13a–13 Quarterly reports on Form 10–Q (§ 249.308a of this chapter).

(a) Except as provided in paragraphs (b) and (c) of this section, every issuer that has securities registered pursuant to section 12 of the Act and is required to file annual reports pursuant to section 13 of the Act on Form 10–K (§ 249.310 of this chapter) or U5S (§ 259.5s of this chapter) shall file a quarterly report on Form 10–Q (§ 249.308a of this chapter)

within the period specified in General Instruction A.1. to that form for each of the first three quarters of each fiscal year of the issuer, commencing with the first fiscal quarter following the most recent fiscal year for which full financial statements were included in the registration statement, or, if the registration statement included financial statements for an interim period subsequent to the most recent fiscal year end meeting the requirements of Article 10 of Regulation S–X, for the first fiscal quarter subsequent to the quarter reported upon in the registration statement. The first quarterly report of the issuer shall be filed either within 45 days after the effective date of the registration statement or on or before the date on which such report would have been required to be filed if the issuer has been required to file reports on Form 10–Q as of its last fiscal quarter, whichever is later.

* * * * *

5. By amending § 240.14a–3 by redesignating the Note to paragraph (b)(1) as Note 1 and adding Note 2 to paragraph (b)(1) to read as follows:

§ 240.14a–3 Information to be furnished to security holders.

(b) * * *

(1) * * *

Note 2.—For purposes of complying with § 240.14a–3, if the registrant, other than a registered investment company, has changed its fiscal closing date, financial statements covering two years and one period of 9 to 12 months shall be deemed to satisfy the requirements for statements of income and cash flows for the three most recent fiscal years.

* * * * *

6. By revising § 240.15d–10 to read as follows:

§ 240.15d–10 Transition reports.

(a) Every issuer that changes its fiscal closing date shall file a report covering the resulting transition period between the closing date of its most recent fiscal year and the opening date of its new fiscal year; *Provided, however,* that an issuer shall file an annual report for any fiscal year that ended before the date on which the issuer determined to change its fiscal year end. In no event shall the transition report cover a period of 12 or more months.

(b) The report pursuant to this section shall be filed for the transition period not more than 90 days after either the close of the transition period or the date of the determination to change the fiscal closing date, whichever is later. The report shall be filed on the form appropriate for annual reports of the issuer, shall cover the period from the close of the last fiscal year end and shall indicate clearly the period covered. The financial statements for the transition period filed therewith shall be audited. Financial statements, which may be unaudited, shall be filed for the comparable period of the prior year, or a footnote, which may be unaudited, shall state for the comparable period of the prior year, revenues, gross profits, income taxes, income or loss from continuing operations before extraordinary items and cumulative effect of a change in accounting principles and net income or loss. The effects of any discontinued operations and/or extraordinary items as classified under the provisions of generally accepted accounting principles also shall be shown, if applicable. Per share data based upon such income or loss and net income or loss shall be presented in conformity with applicable accounting standards. Where called for by the time span to be covered, the comparable period financial statements or footnote shall be included in subsequent filings.

(c) If the transition period covers a period of less than six months, in lieu of the report required by paragraph (b) of this section, a report may be filed for the transition period on Form 10–Q (§ 249.308a of this chapter) not more than 45 days after either the close of the transition period or the date of the determination to change the fiscal closing date, whichever is later. The report of Form 10–Q shall cover the period from the close of the last fiscal year end and shall indicate clearly the period covered. The financial statements filed therewith need not be audited but, if they are not audited, the issuer shall file with the first annual report for the newly adopted fiscal year separate audited statements of income and cash flows covering the transition period. The notes to financial statements for the transition period included in such first annual report may be integrated with the notes to financial statements for the full fiscal period. A separate audited balance sheet as of the end of the transition period shall be filed in the annual report only if the audited balance sheet as of the end of the fiscal year prior to the transition period is not filed. Schedules need not be filed in transition reports on Form 10–Q.

(d) Notwithstanding the foregoing in paragraphs (a), (b), and (c) of this section, if the transition period covers a period of one month or less, the issuer need not file a separate transition report if either:

(1) the first report required to be filed by the issuer for the newly adopted fiscal year after the date of the determination to change the fiscal year end is an annual report, and that report covers the transition period as well as the fiscal year; or

(2)(i) the issuer files with the first annual report for the newly adopted fiscal year separate audited statements of income and cash flows covering the transition period; and

(ii) the first report required to be filed by the issuer for the newly adopted fiscal year after the date of the determination to change the fiscal year end is a quarterly report on Form 10–Q and

(iii) Information on the transition period is included in the issuer's quarterly report on Form 10–Q for the first quarterly period (except the fourth quarter) of the newly adopted fiscal year that ends after the date of the determination to change the fiscal year. The information covering the transition period required by Part II and Item 2 of Part I may be combined with the information regarding the quarter. However, the financial statements required by Part I, which may be unaudited, shall be furnished separately for the transition period.

(e) Every issuer required to file quarterly reports on Form 10–Q pursuant to § 240.15d–13 of this chapter that changes its fiscal year end shall:

(1) File a quarterly report on Form 10–Q within the time period specified in General Instruction A.1. to that form for any quarterly period (except the fourth quarter) of the old fiscal year that ends before the date on which the issuer determined to change its fiscal year end, except that the issuer need not file such quarterly report if the date on which the quarterly period ends also is the date on which the transition period ends;

(2) File a quarterly report on Form 10–Q within the time specified in General Instruction A.1. to that form for each quarterly period of the old fiscal year within the transition period. In lieu of a quarterly report for any quarter of the old fiscal year within the transition period, the issuer may file a quarterly report on Form 10–Q for any period of three months within the transition period that coincides with a quarter of the newly adopted fiscal year if the quarterly report is filed within 45 days after the end of such three month period, provided the issuer thereafter continues filing quarterly reports on the basis of the quarters of the newly adopted fiscal year;

(3) Commence filing quarterly reports for the quarters of the new fiscal year no later than the quarterly report for the first quarter of the new fiscal year that ends after the date on which the issuer

determined to change the fiscal year end; and

(4) Unless such information is or will be included in the transition report, or the first annual report on Form 10–K for the newly adopted fiscal year, include in the initial quarterly report on Form 10–Q for the newly adopted fiscal year information on any period beginning on the first day subsequent to the period covered by the issuer's final quarterly report on Form 10–Q or annual report on Form 10–K for the old fiscal year. The information covering such period required by Part II and Item 2 of Part I may be combined with the information regarding the quarter. However, the financial statements required by Part I, which may be unaudited, shall be furnished separately for such period.

Note to paragraphs (c) and (e): If it is not practicable or cannot be cost-justified to furnish in a transition report on Form 10–Q or a quarterly report for the newly adopted fiscal year financial statements for corresponding periods of the prior year where required, financial statements may be furnished for the quarters of the preceding fiscal year that most nearly are comparable if the issuer furnishes an adequate discussion of seasonal and other factors that could affect the comparability of information or trends reflected, an assessment of the comparability of the data, and a representation as to the reason recasting has not been undertaken.

(f) Every successor issuer that has a different fiscal year from that of its predecessor(s) shall file a transition report pursuant to this section, containing the required information about each predecessor, for the transition period, if any, between the close of the fiscal year covered by the last annual report of each predecessor and the date of succession. The report shall be filed for the transition period on the form appropriate for annual reports of the issuer not more than 90 days after the date of the succession, with financial statements in conformity with the requirements set forth in paragraph (b) of this section. If the transition period covers a period of less than six months, in lieu of a transition report on the form appropriate for the issuer's annual reports, the report may be filed for the transition period on Form 10–Q not more than 45 days after the date of the succession, with financial statements in conformity with the requirements set forth in paragraph (c) of this section. Notwithstanding the foregoing, if the transition period covers a period of one month or less, the successor issuer need not file a separate transition report if the information is reported by the successor issuer in conformity with the requirements set forth in paragraph (d) of this section.

(g)(1) Paragraphs (a) through (f) of this section shall not apply to foreign private issuers authorized to use Form 20–F (§ 249.220f of this chapter) for annual reports required by Rule 15d–1 (§ 240.15d–1 of this chapter).

(2) Every foreign private issuer that changes its fiscal closing date shall file a report covering the resulting transition period between the closing date of its most recent year and the opening date of its new fiscal year. In no event shall a transition report cover a period longer than 12 months.

(3) The report for the transition period shall be filed on Form 20–F responding to all items to which such issuer is required to respond when Form 20–F is used as an annual report. Such report shall be filed within six months after either the close of the transition period or the date on which the issuer made the determination to change the fiscal closing date, whichever is later. The financial statements for the transition period filed therewith shall be audited.

(4) If the transition period covers a period of six or fewer months, in lieu of the report required by paragraph (g)(3) of this section, a report for the transition period may be filed on Form 20–F responding to Items, 3, 9, 15, 16, and 17 or 18 within three months after either the close of the transition period or the date on which the issuer made the determination to change the fiscal closing date, whichever is later. The financial statements required by either Item 17 or Item 18 shall be furnished for the transition period. Such financial statements may be unaudited and condensed as permitted in Article 10 of Regulation S–X (§ 210.10–01 of this chapter), but if the financial statements are unaudited and condensed, the issuer shall file with the first annual report for the newly adopted fiscal year separate audited statements of income and cash flows covering the transition period.

(5) Notwithstanding the foregoing in paragraphs (g)(2), (g)(3), and (g)(4) of this section, if the transition period covers a period of one month or less, a foreign private issuer need not file a separate transition report if the first annual report for the newly adopted fiscal year covers the transition period as well as the fiscal year.

(h) The provisions of this rule shall not apply to investment companies required to file reports pursuant to Rule 30b1–1 (§ 270.30b1–1 of this chapter) under the Investment Company Act of 1940 (15 U.S.C. 80a–1 *et seq.*).

(i) No filing fee shall be required for a transition report filed pursuant to this section.

Note:—In addition to the report or reports required to be filed pursuant to this section, every issuer, except a foreign private issuer authorized to use Form 20–F for annual reports required by Rule 15d–1 or an investment company required to file reports pursuant to Rule 30b1–1 under the Investment Company Act of 1940, that changes its fiscal closing date is required to file a report on Form 8–K responding to Item 8 thereof within the period specified in General Instruction B.1. to that form.

7. By amending § 240.15d–13 by revising paragraph (a) to read as follows:

§ 240.15d–13 Quarterly reports on Form 10–Q (§ 249.308a of this chapter).

(a) Except as provided in paragraphs (b) and (c) of this section, every issuer that has securities registered pursuant to the Securities Act of 1933 and is required to file annual reports pursuant to section 15(d) of the Securities Exchange Act of 1934 on Form 10–K (§ 249.310 of this chapter) or U5S (§ 259.5s of this chapter) shall file a quarterly report on Form 10–Q (§ 249.308a of this chapter) within the period specified in General Instruction A.1. to that form for each of the first three quarters of each fiscal year of the issuer, commencing with the first fiscal quarter following the most recent fiscal year for which full financial statements were included in the registration statement, or, if the registration statement included financial statements for an interim period subsequent to the most recent fiscal year end meeting the requirements of Article 10 of Regulation S–X, for the first fiscal quarter subsequent to the quarter reported upon in the registration statement. The first quarterly report of the issuer shall be filed either within 45 days after the effective date of the registration statement or on or before the date on which such report would have been required to be filed if the issuer had been required to file reports on Form 10–Q as of its last fiscal quarter, whichever is later.

* * * * *

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 249 continues to read, in part, as follows:

Authority: The Securities Exchange Act of 1934, 15 U.S.C. 78a, *et seq.* * * *

2. By amending § 249.220f by revising the section heading and paragraphs (a) and (b), and adding a new paragraph (d) as set forth below.

Form 20–F is amended by revising the cover sheet above the line beginning with the words "Commission file

number" and revising paragraphs (a) and (b) of, and adding a new paragraph (d) to General Instruction A as set forth below.

Note:—The text of Form 20–F does not appear in the Code of Federal Regulations.

§ 249.220f Form 20–F, registration of securities of foreign private issuers pursuant to section 12(b) or (g) and annual and transition reports pursuant to sections 13 and 15(d).

(a) Any non-Canadian foreign private issuer may use this form as a registration statement under section 12 of the Securities Exchange Act (the "Exchange Act"), or as an annual or transition report filed under section 13(a) or 15(d) of the Exchange Act.

(b) A Canadian foreign private issuer may use this form as a registration statement under section 12(g) of the Exchange Act or as an annual or transition report under section 13(a) for a class of securities registered under section 12(g) only if such issuer does not have or has not had during the 12 months prior to the filing of the registration statement or annual or transition report any class of securities registered under section 12(b) of the Exchange Act or a reporting obligation (suspended or active) under section 15(d) of the Exchange Act and if such issuer has not issued its securities in a transaction to acquire by merger, consolidation, exchange of securities or acquisition of assets another issuer that filed or was required to file an annual report on Form 10–K (§ 240.310 of this chapter).

* * * * *

(d) A transition report on this form shall be filed in accordance with the requirements set forth in § 240.13a–10 or § 240.15d–10 applicable when the issuer changes its fiscal year end.

United States
Securities and Exchange Commission
Washington, DC 20549
Form 20–F
(Mark One)
[ ] Registration statement pursuant to section 12(b) or (g) of the Securities Exchange Act of 1934 [*Fee Required*] or
[ ] Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 [*Fee Required*]
For the fiscal year ended _____ or
[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 [*No Fee Required*]
For the transition period from _____ to _____

* * * * *

General Instructions

A. Rule as to Use of Form 20–F.

(a) Any non-Canadian foreign private issuer may use this form as a registration statement under section 12 of the Securities Exchange Act of 1934 (the "Exchange Act") or as an annual or transition report filed under section 13(a) or 15(d) of the Exchange Act.

(b) A Canadian foreign private issuer may use this form as a registration statement under section 12(g) of the Exchange Act and as an annual or transition report under section 13(a) for a class securities registered under section 12(g) only if such issuer does not have or has not had during the 12 months prior to the filing of the registration statement or annual or transition report any class of securities registered under section 12(b) of the Exchange Act or a reporting obligation (suspended or active) under section 15(d) of the Exchange Act and if such issuer has not issued its securities in a transaction to acquire by merger, consolidation, exchange of securities or acquisition of assets another issuer that filed or was required to file an annual report on Form 10–K (§ 249.310 of this chapter).

* * * * *

(d) A transition report on this form shall be filed in accordance with the requirements set forth in § 240.13a–10 or § 240.15d–10 applicable when the issuer changes its fiscal year end.

* * * * *

3. By amending Form 8–K (§ 249.308) by adding a sentence to the end of General Instruction B.1. and adding new Item 8 as set forth below.

Note.—The text of Form 8–K does not appear in the Code of Federal Regulations.

§ 249.308 Form 8–K, for current reports.

* * * * *

United States
Securities and Exchange Commission
Washington, DC 20549
Form 8–K

* * * * *

General Instructions

* * * * *

B. Events to be Reported and Time for Filing of Reports

1. * * * A report on this form pursuant to Item 8 is required to be filed within 15 calendar days after the date on which the registrant makes the determination to use a fiscal year end different from that used in its most recent filing with the Commission.

* * * * *

Item 8. Change in Fiscal Year

If the registrant determines to change the fiscal year from that used in its most recent filing with the Commission, state the date of such determination, the date of the new fiscal year end, and the Form (*e.g.*, Form 10–K or Form 10–Q) on which the report covering the transition period will be filed.

* * * * *

4. By amending § 249.308a by revising the section heading, the second sentence, and adding two new sentences after the second sentence as set forth below.

Form 10–Q is amended by revising General Instructions A.1. and A.2. and revising the cover sheet above the line beginning with the words "Commission file number" as set forth below.

Note.—The text of Form 10–Q does not appear in the Code of Federal Regulations.

§ 249.308a Form 10–Q, for quarterly and transition reports under section 13 or 15(d) of the Securities Exchange Act of 1934.

* * * A quarterly report on this form pursuant to § 240.13a–13 or § 240.15d–13 of this chapter shall be filed within 45 days after the end of the first three fiscal quarters of each fiscal year, but no quarterly report need be filed for the fourth quarter of any fiscal year. Form 10–Q also shall be used for transition and quarterly reports filed pursuant to § 240.13a–10 or § 240.15d–10 of this chapter. Such transition or quarterly reports shall be filed in accordance with the requirements set forth in § 240.13a–10 or § 240.15d–10 applicable when the registrant changes its fiscal year end.

United States
Securities and Exchange Commission
Washington, DC 20549
Form 10–Q

General Instructions

A. Rule as to Use of Form 10–Q.

1. Form 10–Q shall be used for quarterly reports under Section 13 or 15(d) of the Securities Exchange Act of 1934, filed pursuant to Rule 13a–13 (17 CFR 240.13a–13) or Rule 15d–13 (17 CFR 240.15d–13). A quarterly report on this form pursuant to Rule 13a–13 or Rule 15d–13 shall be filed within 45 days after the end of each of the first three fiscal quarters of each fiscal year. No report need be filed for the fourth quarter of any fiscal year.

2. Form 10–Q also shall be used for transition and quarterly reports under section 13 or 15(d) of the Securities Exchange Act of 1934, filed pursuant to Rule 13a–10 (17 CFR 240.13a–10) or Rule 15d–10 (17 CFR 240.15d–10). Such transition or quarterly reports shall be filed in accordance with the requirements set forth in Rule 13a–10 or Rule 15d–10 applicable when the registrant changes its fiscal year end.

* * * * *

United States
Securities and Exchange Commission
Washington, DC 20549
Form 10–Q
(Mark One)
[ ] Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended _____ or
[ ] Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the Transition period from _____ to _____

* * * * *

5. By amending § 249.310 by revising the section heading and the text of the section, except for the first and last sentences as set forth below.

Form 10–K is amended by revising General Instruction A, except for the first and last sentences, and the cover sheet above the line designated for the "Exact name of the registrant as specified in its charter" as set forth below.

Note.—The text of Form 10–K does not appear in the Code of Federal Regulations.

§ 249.310 Form 10–K, for annual and transition reports pursuant to sections 13 or 15(d) of the Securities Exchange Act of 1934.

* * * This form also shall be used for transition reports filed pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934. Annual reports on this form shall be filed within 90 days after the end of the fiscal year covered by the report. Transition reports on this form shall be filed in accordance with the requirements set forth in § 240.13a–10 or § 240.15d–10 applicable when the registrant changes its fiscal year end. However, all schedules required by Article 12 of Regulation S–X may, at the option of the registrant, be filed as an amendment to the annual report not later than 120 days after the end of the fiscal year covered by the report or, in the case of a transition report, not later than 30 days after the due date of the report. * * *

United States
Securities and Exchange Commission
Washington, DC 20549
Form 10–K

General Instructions

A. Rule as to Use of Form 10–K.

* * * This Form also shall be used for transition reports filed pursuant to section 13 or 15(d) of this Act. Annual reports on this form shall be filed within 90 days after the end of the fiscal year covered by the report. Transition reports on this form shall be filed in accordance with the requirements set forth in § 240.13a–10 and § 240.15d–10 applicable when the registrant changes its fiscal year end. However, all schedules required by Article 12 of Regulation S–X may, at the option of the registrant, be filed as an amendment to the annual report not later than 120 days after the end of the fiscal year covered by the report or, in the case of a transition report, not later than 30 days after the due date of the report. * * *

* * * * *

United States
Securities and Exchange Commission
Washington, DC 20549
Form 10–K
(Mark One)
[ ] Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 [*Fee Required*]
For the fiscal year ended _____ or
[ ] Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 [*No Fee Required*]
For the transition period from _____ to _____
Commission file number _____

* * * * *

6. By amending § 249.322 by revising the first sentence as set forth below.

Form 12b–25 is amended by revising the cover sheet above the line reading "Read Instructions (on back page) Before Preparing Form. Please Print or Type," paragraph (b) of Part II, and the first sentence of Part III as set forth below.

Note.—The text of Form 12b–25 does not appear in the Code of Federal Regulations.

§ 249.322 Form 12b–25, notification of late filing.

This form shall be filed pursuant to § 240.12b–25 of this chapter by issuers who are unable to file timely all or any required portion of an annual or transition report on Form 10–K, 20–F, or 11–K or a quarterly or transition report on Form 10–Q pursuant to section 13 or 15(d) of the Act or a semi-annual, annual or transition report on Form N–SAR pursuant to section 30 of the Investment Company Act of 1940. * * *

United States
Securities and Exchange Commission
Washington, DC 20549
Form 12b–25
Notification of Late Filing (Check One).
[ ] Form 10–K, —Form 20–F, —Form 11–K, —Form 10–Q, —Form N–SAR
For Period Ended:_____
[ ] Transition Report on Form 10–K
[ ] Transition Report on Form 20–F
[ ] Transition Report on Form 11–K
[ ] Transition Report on Form 10–Q
[ ] Transition Report on Form N–SAR
For the Transition Period Ended: _____

* * * * *

Part II—Rules 12b–25(b) and (c)

* * * * *

(a) * * *

(b) The subject annual report, semi-annual report, transition report on Form 10–K, Form 20–F, 11–K or Form N–SAR, or portion thereof will be filed on or before the fifteenth calendar day following the prescribed due date; or the subject quarterly report or transition report on Form 10–Q, or portion thereof will be filed on or before the fifth calendar day following the prescribed due date; and

* * * * *

Part III—Narrative

State below in reasonable detail the reasons why Forms 10–K, 20–F, 11–K, 10–Q, N–SAR, or the transition report or portion thereof could not be filed within the prescribed time period.

* * * * *

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

1. The authority citation for Part 270 continues to read, in part, as follows:

Authority: Secs. 38, 40, 54 Stat. 841, 842; 15 U.S.C. 80a–37, 80c–89; the Investment Company Act of 1940, as amended, 15 U.S.C. 80a–1, *et seq.* * * *

2. By revising § 270.8b–16 to read as follows:

§ 270.8b–16 Amendments to registration statement.

Every registered management investment company which is required to file a semi-annual report on Form N–SAR, as prescribed by rule 30b1–1 (17 CFR 270.30b1–1), shall amend the registration statement required pursuant to Section 8(b) by filing, not more than 120 days after the close of each fiscal year ending on or after the date upon which such registration statement was filed, the appropriate form prescribed for such amendments.

3. By revising § 270.30b1–2 to read as follows:

§ 270.30b1–2 Semi-annual report for totally-owned registered management investment company subsidiary of registered management investment company.

Notwithstanding the provisions of rules 30a–1 and 30b1–1, a registered investment company that is a totally-owned subsidiary of a registered management investment company need not file a semi-annual report on Form N–SAR if financial information with respect to that subsidiary is reported in the parent's semi-annual report on Form N–SAR.

4. By adding § 270.30b1–3 to read as follows:

§ 270.30b1–3 Transition reports.

Every registered management investment company filing reports on Form N–SAR that changes its fiscal year end shall file a report on Form N–SAR not more than 60 calendar days after the later of either the close of the transition period or the date of the determination to change the fiscal year end which report shall not cover a period longer than six months. No filing fee shall be required for a transition report filed pursuant to this rule.

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

1. The authority citation for Part 274 continues to read, in part, as follows:

Authority: The Investment Company Act of 1940, 15 U.S.C. 80a–1 *et seq.* * * *

2. By amending § 274.101 by revising the text of the section as set forth below.

Form N–SAR is amended by revising page 1 above the line indicating whether the filing is in an amendment, and

General Instructions A, C (except the last two paragraphs which will remain the same), and F(2).

Note.—The text of Form N–SAR does not appear in the Code of Federal Regulations.

§ 271.101 Form N–SAR, semi-annual report of registered investment companies.

This form shall be used by registered investment companies for semi-annual or annual reports to be filed pursuant to rule 30a–1 (17 CFR 270.30a–1) or 30b1–1 (17 CFR 270.30b1–1) in satisfaction of the requirement of section 30(a) of the Investment Company Act of 1940 that every registered investment company must file annually with the Commission such information, documents and reports as investment companies having securities registered on a national securities exchange are required to file annually pursuant to section 13(a) of the Securities Exchange Act of 1934 and the rules and regulations thereunder (same as § 249.330 of this chapter).

Form N–SAR

Semi-Annual Report for registered investment companies

Report for six month period ending: ——— / ——— / ——— (a); or fiscal year ending: ——— / ——— / ——— (b).

Report for the transition period ending: ——— / ——— / ——— (c).

[If transition report also complete (a) or (b) above.]

* * * * *

General Instructions

A. Use of Form N–SAR

Form N–SAR is a combined reporting form that is to be used for semi-annual and annual reports by all investment companies which have filed a registration statement which has become effective pursuant to the Securities Act of 1933 ("1933 Act") with the exception of face amount certificate companies. Face amount certificate companies file periodic reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 ("1934 Act"). Form N–SAR is also used for transition reports pursuant to Rule 30b1–3 under the Investment Company Act of 1940 (the "Act"). The form is divided into four sections and only certain investment companies are to complete each section.

* * * * *

Unit Investment Trusts:

* * * * *

Under section 30(b) of the Act, sections 13 and 15(d) of the 1934 Act, and the rules and regulations thereunder, the Commission is authorized to solicit the information required by Form N–SAR from registered investment companies. Disclosure of the information specified by Form N–SAR is mandatory. Information supplied on Form N–SAR will be included routinely in the public files of the Commission and will be available for inspection by any interested persons.

* * * * *

C. Filing the Report

The report shall be filed with the Commission no later than the sixtieth day after the end of the fiscal period for which the report is being prepared. All registered management investment companies shall file the form semi-annually. All registered UITs shall file the form annually. An extension of time of up to 15 days for filing the form may be obtained by following the procedures specified in Rule 12b–25 under the 1934 Act.

All transition reports shall be filed no later than the sixtieth day after the later of either the close of the transition period or the date of the determination to change the fiscal year. However, the transition report may not cover a period longer than six months.

Rule 30b1–1 under the Act requires a $125 fee to be paid to the Commission at the time of filing each semi-annual report by open- and closed-end management investment companies and a $125 fee to be paid at the time of filing each annual report by a UIT. No fee is required for a transition report.

* * * * *

F. Preparation of the Report by Electronic users

* * * * *

(2) Electronic filers may use the lockbox procedure as described in paragraph 220 of the Edgar User Manual to pay the filing fee required by Rule 30b1–1.

By the Commission.

Jonathan G. Katz,

Secretary.

March 2, 1989.

[FR Doc. 89–5576 Filed 3–10–89; 8:45 am]

BILLING CODE 8010–01–M

DEPARTMENT OF THE TREASURY

Customs Service

19 CFR Parts 10, 24 and 148

United States-Canada Free Trade Agreement; Extension of Time for Comments

March 6, 1989.

AGENCY: U.S. Customs Service, Treasury.

ACTION: Extension of time for comments.

SUMMARY: This notice extends the period of time within which interested members of the public may submit comments concerning the interim regulations on the United States-Canada Free Trade Agreement (CFTA). A notice inviting the public to comment on the CFTA was published in the Federal Register on December 23, 1988 (53 FR 51762), and comments were to have been received before February 21, 1989. A request has been received to extend the period of time for comments for an additional 30 days. In view of the complexity of issues and subjects involved, the request is granted.

This extension of time to file comments will not affect procedures and practices related to the implementation of duty preferences under the CFTA, since interim regulations governing these areas are currently in effect.

DATES: The time for comments is extended through March 23, 1989.

ADDRESS: Comments (preferably in triplicate) should be submitted to and may be inspected at the Regulations and Disclosure Law Branch, U.S. Customs Service, Room 2119, U.S. Customs Service, 1301 Constitution Avenue, NW., Washington, DC 20229.

FOR FURTHER INFORMATION CONTACT: Joseph J. DeSanctis, Regulations and Disclosure Law Branch (202–566–8237).

Dated: March 6, 1989.

Harvey B. Fox,

Director, Office of Regulations and Rulings.

[FR Doc. 89–5679 Filed 3–10–89; 8:45 am]

BILLING CODE 4820–02–M

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[FRL–3513–8]

Approval and Promulgation of Implementation Plans; State of Missouri

AGENCY: Environmental Protection Agency (EPA).

ACTION: Final rule.

SUMMARY: EPA is approving revised Missouri regulations for the control of volatile organic compound (VOC) emissions in the Kansas City area. These regulations were submitted in response to Part D of the Clean Air Act which requires state implementation plan (SIP) revisions for areas that have not attained the National Ambient Air Quality Standards. Today's action provides federal enforceability for these regulations which assures continued progress toward attainment and maintenance of the ozone air quality standard in Kansas City.

EFFECTIVE DATE: This action is effective April 12, 1989.

ADDRESSES: The state submittal and EPA's technical support document are available for inspection during normal business hours at the following locations: Environmental Protection Agency, Region VII, 726 Minnesota Avenue, Kansas City, Kansas 66101; Missouri Department of Natural Resources, Air Pollution Control Program, Jefferson State Office Building, 205 Jefferson Street, Jefferson City,